TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 708

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CREDIT ALLIANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 21, 1941
CERTIORARI GRANTED NOVEMBER 24, 1941

SUPREME COURT OF THE UNITED STATES

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CREDIT ALLIANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 100561

CREDIT ALLIANCE CORPORATION, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Petitioner—Dean Acheson, Esq.; Jack J. Levinson, Esq.; W. Graham Claytor, Jr., Esq.; Newell W. Ellison, Esq. For Respondent: Joe D. Hughes, Esq.

Docket entries

1939

Nov. 6—Petition received and filed. Taxpayer notified. (Fee paid.)

Nov. 6—Copy of petition served on General Counsel.

Nov. 6—Request for hearing in Washington, D. C., filed by taxpayer. 11/6/39 copy served.

Dec. 9—Answer filed by General Counsel.

Dec. 12—Copy of answer served on taxpayer—Washington, D. C. Calendar.

1940

Apr. 9—Hearing set May 16, 1940.

May 16—Hearing had before Mr. Disney on merits. Consolidated for hearing with #100560. Stipulation of facts and appearance of W. Graham Claytor, Jr., filed. Briefs due in 45 days—replies in 15 days.

May 23—Brief filed by taxpayer.

May 27—Transcript of hearing 5/16/40 filed.

July 19—Motion for leave to file brief filed by General Counsel. 7/19/40 granted.

July 19—Brief filed by General Counsel.

July 22—Copy of brief served on General Counsel.

Oct. 22—Findings of fact and opinion rendered—Mr. Disney. Decision will be entered for petitioner.

Oct. 25—Decision entered—R. L. Disney, Division 4.

1941

Jan. 17—Petition for review by U. S. Circuit Court of Appeals, Fourth Circuit, with assignments of error filed by General Counsel.

Jan. 23—Proof of service filed by General Counsel (taxpayer).

Jan. 23—Proof of service of petition for review filed (counsel).

Feb. 17—Motion for extension to April 17, 1941, to complete and transmit record filed by General Counsel.

Feb. 17—Order enlarging time to April 17, 1941, to complete and transmit record, entered.
Apr. 9—Notice of appearance of Newell W. Ellison as counsel filed.
Apr. 10—Statement of points filed with proof of service thereon.
Apr. 10—Agreed designation of portions of record, proceedings, and evidence to be contained in the record filed. Proof of service thereon.

2 Before United States Board of Tax Appeals

Docket No. 100561

CREDIT ALLIANCE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

Petition

Filed Nov. 6, 1939

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SND–IT) dated August 9, 1939, and as a basis of its proceeding alleges as follows:

(1) The petitioner was incorporated in 1922 under the laws of the State of New York and was voluntarily dissolved on July 6, 1937. Under Section 29 of the New York General Corporation Law, the petitioner's corporate existence continues for the purpose of taking any action required to adjust and wind up its business and affairs, and it may sue or be sued in its corporate name. Under said law the directors and officers of the petitioner have full power and authority to take all action necessary to settle the petitioner's affairs, including the power to authorize the filing of this petition and to cerify the same.

The return of the petitioner was filed with the Collector for the District of Maryland.

3 (2) The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on August 9, 1939.

(3) The taxes in controversy are income taxes (corporation undistributed profits surtax) for the calendar year 1936, and in the amount of $121,814.49.

(4) The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The respondent erred in disallowing to the petitioner a dividends paid credit of $947,228.40 for the calendar year 1936.

3.

and in not allowing the petitioner the full dividends paid credit claimed in its return of $950,734.80;

(b) The respondent erred in determining that the undistributed net income of the petitioner for the year 1936 was 595,328.76 or any sum whatsoever;

(c) The respondent erred in determining that there is a deficiency of $121,814.49 or any sum whatsoever in the income tax liability of the petitioner for the year 1936.

(5) The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) The petitioner was organized under the laws of New York in 1922. From the time of its organization until its liquidation in 1936–1938, it was actively engaged in the commercial banking business. During the year 1930 Commercial Credit Company (Delaware), which was and is engaged in the same business, acquired over 80 percent of all classes of the petitioner's outstanding capital stock, and gradually increased its holdings in said stock until on December 1, 1936, and thereafter until all the capital stock was cancelled or redeemed, it owned 526,238 out of 528,186 outstanding shares, or 99.63% of all of the petitioner's outstanding capital stock.

4

(b) In 1936, in order to simplify the corporate structure, it was decided to liquidate and dissolve the petitioner in accordance with the provisions of Section 112 (b) (6) of the Revenue Act of 1936. Accordingly, on December 1, 1936, at a special meeting of the stockholders, it was resolved completely to liquidate the corporation pursuant to a plan of liquidation under which the distribution of all its property was to be completed within three years from the close of the calendar year 1936, with ultimate cancellation or redemption of all its outstanding capital stock. At the same meeting it was resolved that a distribution of property in liquidation equivalent to $1.80 per share be made out of surplus on December 10, 1936, to the stockholders of record as of December 3, 1936. It was also resolved that the capital of the corporation be reduced from $4,225,488.00 to $528,186.00, that the stated value of the 528,186 shares of capital stock accordingly be reduced from $8.00 per share to $1.00 per share, and that the difference of $7.00 per share be distributed as a "distribution of property in liquidation" on December 10, 1936, to stockholders of record as of December 3, 1936.

5

(c) Pursuant to the foregoing resolutions, the petitioner on December 10, 1936, distributed to its stockholders, out of surplus, cash and property of the value of $950,734.80, of which Commercial Credit Company (Delaware) received $947,228.40, the entire $950,734.80 being distributed out of surplus, all of which constituted earnings and profits accumulated after Feb-

ruary 28, 1913. It likewise distributed on the same day to its stockholders cash and property of the value of $3,697,302.00, of which Commercial Credit Company (Delaware) received $3,683,666.00. The entire $3,697,302.00 was distributed from assets made available by the reduction of the capital from $4,225,488.00 to $528,186,00.

(d) Further distributions to the stockholders were made in 1937, and on November 30, 1938, the liquidation of the petitioner was completed and the final distribution made. On July 6, 1937, pursuant to a resolution adopted at a special meeting of the stockholders held the preceding June 1, a certificate of dissolution was filed in the office of the Secretary of State of New York, and the petitioner was therefore formally dissolved on that date. Under the applicable provisions of New York law, the petitioner continues in existence for purposes of liquidating and winding up its affairs and may sue or be sued in its corporate name.

(e) The complete liquidation of the petitioner described above complied with all the provisions of Section 112 (b) (6) of the Revenue Act of 1936. Commercial Credit Company (Delaware), as the owner of 99.63% of all the outstanding shares of
6 stock of the petitioner, has received in liquidation approximately that proportion of its net assets. Under Section 112 (b) (6), no gain or loss was recognized to the Commercial Credit Company (Delaware) on this liquidation.

(f) For the calendar year 1936 the Commercial Credit Company (Delaware) reported a net income of $11,812,303.10. For the same period the petitioner had a net income of $703,147.25, on which it paid a normal tax of $104,312.09. It thus had an adjusted net income of $598,835.16, and in its return claimed a dividends paid credit of $950,734.80. In his 90-day letter to the petitioner, the Commissioner disallowed to the extent of $947,228.40 this dividends paid credit on the ground that this amount was distributed in a complete liquidation under Section 112 (b) (6) of the Revenue Act of 1936 without recognition of gain or loss to the recipient, and so could not be allowed as a dividends paid credit, citing Article 27 (f)-1 of Regulations 94. See Exhibit A, attached hereto.

(g) The petitioner avers that $950,734.80 is the proper credit for dividends paid by it in 1936, that it therefore has no undistributed net income for that year upon which any undistributed profits surtax is due, and that no deficiency exists with respect to its income tax for said year.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine:

(a) That the sum of $950,734.80, representing a distribution in liquidation on December 10, 1936, out of earnings and profits

accumulated since February 28, 1913, is properly allow-
7 able as a dividends paid credit for purposes of computing the undistributed profits surtax of the petitioner for the year 1936.

(b) That there is no deficiency in federal income taxes owing by the petitioner for the year 1936.

And petitioner prays for such other and further relief as the case may require.

DEAN ACHESON,
Dean Acheson,
Attorney for Petitioner,
701 Union Trust Bldg., Washington, D. C.
JACK J. LEVINSON,
Jack J. Levinson,
Attorney for Petitioner,
100 E. 42nd Street, New York City.

Of Counsel:
COVINGTON, BURLING, RUBLEE,
ACHESON & SHORB,
Washington, D. C.
DILLS, MUECKE, SCHELKER
& LEVINSON,
New York City.

8 *Exhibit A to petition*

Form 1230 SN–IT–1

Office of Internal Revenue Agent in Charge, Baltimore Division

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Baltimore, Maryland, August 9, 1939.

CREDIT ALLIANCE CORPORATION,
C/o COMMERCIAL CREDIT COMPANY,
First National Bank Building,
Baltimore, Maryland.

DEAR SIRS: You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1936, discloses a deficiency of $121,814.49 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, 311 Custom House, Balto., Md., for the attention of SND-IT. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (S) J. C. WILMER,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.
SWD/MM

9 STATEMENT

Credit Alliance Corporation, C/o Commercial Credit Company, First National Bank Building, Baltimore, Maryland

Tax Liability for the Taxable Year Ended December 31, 1936

Income Tax: Liability, $226,126.58. Assessed, $104,312.09. Deficiency, $121,814.49.

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated July 16, 1938, and April 3, 1939; to your protest dated May 9, 1939; and to the statements made at the conferences held on May 23, 1939, and June 21, 1939.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		$699,687.63
Unallowable deductions and additional income:		
(a) Depreciation—automobiles	$3,857.35	
(b) Capital stock tax	6,167.48	
		10,024.83
Total		$709,712.46
Nontaxable income and additional deductions:		
(c) Tax on debentures	$942.90	
(d) Profit on sale of automobiles	5,125.42	
(e) Depreciation—furniture and fixtures	496.89	
		6,565.21
Net income adjusted		$703,147.25

Explanation of Adjustments

(a), (b), (c), (d), and (e). These adjustments were fully explained in the revenue agent's report dated July 16, 1938, copy of which was furnished you under date of September 29, 1938, which report is made a part of this letter. Since you agreed to the adjustments, no further explanation is made herein.

Your claim for a dividend paid credit in the amount of $950,734.80 has been allowed to the extent of $3,506.40 and disallowed to the extent of $947,228.40. The amount disallowed represents part of a distribution of property in liquidation made on December 10, 1936, to the Commercial Credit Company, the owner of 100% of the common stock and 99.614+% of the class A stock, the only classes of outstanding stock of your company.

10 Credit Alliance Corporation

This distribution, made pursuant to a resolution adopted at a special meeting of your stockholders held on December 1, 1936, is held to constitute a distribution in complete liquidation as defined by section 112 (b) (6) of the Revenue Act of 1936, and no dividend paid credit is allowable in respect of the said distribution. See article 27 (f)-1 of Regulations 94.

COMPUTATION OF TAX

Income Tax

Normal Tax:	
Taxable net income	$703,147.25
Net income for normal tax computation	$703,147.25
8% of $2,000.00—over $0 to $2,000	160.00
11% of $13,000.00—over $2,000 to $15,000	1,430.00
13% of $25,000.00—over $15,000 to $40,000	3,250.00
15% of $663,147.25—over $40,000	99,472.09
Total normal tax	$104,312.09

Surtax on Undistributed Profits

Taxable net income	$703,147.25
Less: Normal tax	104,312.09
(a) Adjusted net income	$598,835.16
Less: Dividends paid credit	3,506.40
(b) Undistributed net income	$595,328.76
(c) Remainder subject to surtax	$595,328.76
7% of $59,883.52	$4,191.85
12% of $59,883.52	7,186.02
17% of $119,767.03	20,360.40
22% of $119,767.03	26,348.75
27% of $236,027.66	63,727.47
Amount of tax	$121,814.49
Total surtax	121,814.49

Normal tax		$104,312.09
Total income tax (normal tax and surtax)		226,126.58
Income tax assessed (normal tax and surtax):		
Original, Account No. 400200	$103,793.14	
Additional, #2 list, Account No. 400200, Page 0, Line 7	518.95	
		104,312.09
Deficiency of income tax		$121,814.49

11 STATE OF MARYLAND,
City of Baltimore City, ss:

H. E. Spears, being duly sworn, says that he was at the date of dissolution the vice-president of the above-named petitioner; that pursuant to a resolution adopted by the Board of Directors at a meeting held on November 3, 1939, as provided in Section 29 of the New York Stock Corporation Law, he was duly appointed and authorized to continue as such vice-president with all the powers and duties of that office as provided in the bylaws, and was specifically authorized and empowered to execute on behalf of the corporation all necessary affidavits and other documents in connection with this petition; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the facts stated are true except as to those facts stated to be upon information and belief, and those facts he believes to be true.

H. E. SPEARS.

Subscribed and sworn to before me this 3rd day of November, 1939.

[SEAL] Adelaide Hoffman,
Notary Public.

My commission expires May 5, 1941.

12 Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Dec. 9, 1939

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the respondent committed error as alleged in paragraph 4 of the petition and the subparagraphs thereof.

5. (a) Admits the allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that in 1936 it was decided to liquidate
13 and dissolve the Credit Alliance Corporation but denies the remaining allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits that petitioner distributed cash and property of the value of $950,734.80 to its stockholders on December 10, 1936, of which Commercial Credit Company (Delaware) received $947,228.40 as a stockholder. Admits further that petitioner distributed on the same day to its stockholders cash and property of the value of $3,697,302 of which Commercial Credit Company (Delaware) received $3,683,666 as a stockholder. Denies the remaining allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) Admits the allegations contained in subparagraph (d) of paragraph 5 of the petition.

(e) Admits that Commercial Credit Company (Delaware) as the owner of 99.63% of all the outstanding shares of stock of petitioner received in liquidation approximately that proportion of petitioner's net assets, but denies the remaining allegations contained in subparagraph (e) of paragraph 5 of the petition.

(f) Denies that for the calendar year 1936 the Commercial Credit Company (Delaware) reported a net income of $11,812,303.16, but admits the remaining allegations contained in subparagraph (f) of paragraph 5 of the petition.

14 (g) Denies the allegations and averments contained in subparagraph (g) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that petitioner's appeal be denied.

Signed J. P. WENCHEL,
J. P. Wenchel,
J. D. H.,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
CHESTER A. GWINN,
Division Counsel.
JOE D. HUGHES,
Special Attorney, Bureau of Internal Revenue.

15 Before United States Board of Tax Appeals

[Title omitted.]

Stipulation of facts

Filed at hearing May 16, 1940

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts may be taken as true for the purpose of this proceeding and any other proceeding consolidated for hearing with it by proper motion, and that the same may be considered by the Board as offered in evidence by the parties to this proceeding; provided, however, that this stipulation shall be without prejudice to the right of either of the parties to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. The petitioner was incorporated in 1922 under the
16 laws of the State of New York and was voluntarily dissolved on July 6, 1937. Under Section 29 of the New York General Corporation Law, the petitioner's corporate existence continues for the purpose of taking any action required to adjust and wind up its business and affairs, and it may sue or be sued in its corporate name. Under said law the directors and officers of the petitioner have full power and authority to take all action necessary to settle the petitioner's affairs, including the power to authorize the filing of the petition in this proceeding and to verify the same. The return of the petitioner for the calendar year 1936 was filed with the Collector of Internal Revenue for the District of Maryland.

2. The notice of deficiency, a true copy of which is attached to the petition heretofore filed in this proceeding and marked "Exhibit A" thereto, and which is incorporated herein by reference for the purpose of showing respondent's determination, was mailed to the petitioner on August 9, 1939. Respondent asserted therein a deficiency of $121,814.49 in income taxes (corporation undistributed profits surtax) for the calendar year 1936. Within the time prescribed by law, a proper petition was duly filed with the United States Board of Tax Appeals by the taxpayer.

3. From the time of petitioner's incorporation under the laws of the State of New York in 1922 until its liquidation in
1936-1938, it was actively engaged in the business of
17 financing the purchase of goods at wholesale and retail on the deferred payment plan. During the year 1930, Commercial Credit Company (Delaware), which was and is engaged

in the same business, acquired over 80 percent of each of the two classes of the petitioner's outstanding capital stock, and gradually increased its holdings in said stock until, on or before December 1, 1936, it owned 526,238 out of 528,186 outstanding shares, or 99.63% of all of the petitioner's outstanding capital stock. These holdings remained unchanged until all the capital stock was cancelled or redeemed.

4. In 1936, in order to simplify the corporate structure, it was decided to liquidate and dissolve the petitioner in accordance with the provisions of Section 112 (b) (6) of the Revenue Act of 1936. Accordingly, on December 1, 1936, at a special meeting of the stockholders, it was resolved completely to liquidate the corporation pursuant to a plan of liquidation under which the distribution of all its property was to be completed within three years from the close of the calendar year 1936, with ultimate cancellation or redemption of all its outstanding capital stock. At the same meeting it was resolved that a distribution of property in liquidation equivalent to $1.80 per share be made out of surplus on December 10, 1936, to the stockholders of record as of December 3, 1936. It was also resolved that the capital of the corporation be reduced from $4,225,488.00 to $528,186.00, that the stated
18 value of the 528,186 shares of capital stock accordingly be reduced from $8.00 per share to $1.00 per share, and that the difference of $7.00 per share be distributed as a "distribution of property in liquidation" on December 10, 1936, to stockholders of record as of December 3, 1936. Attached hereto marked "Exhibit 1" and incorporated in and made a part hereof by reference is a true and correct photostatic copy of the minutes of the above-mentioned meeting of the stockholders of December 1, 1936. Similar resolutions were passed at a meeting of the Board of Directors held subsequently on the same day.

5. Pursuant to the foregoing resolutions, the petitioner on December 10, 1936, distributed to its stockholders, out of earned surplus, cash and property of the value of $950,734.80, of which Commercial Credit Company (Delaware), as a stockholder, received $947,228.40. This entire distribution had an aggregate value of $950,734.80, considering the value of the property at its adjusted basis in the hands of petitioner at the time the dividend was paid, or at its fair market value at that time, whichever is lower. The earned surplus account of petitioner represented, in its entirety, earnings and profits accumulated since February 28, 1913; and there was no paid-in surplus. The petitioner likewise distributed on the same day to its stockholders cash and property

of the value of $3,697.302.00, of which Commercial Credit Company (Delaware), as a stockholder, received $3,683,666.00,
19 the entire sum being distributed from assets made available for distribution by the reduction of the capital from $4,225,488.00 to $528,186.00.

6. Further distributions to the stockholders were made in 1937, and on November 30, 1938, the liquidation of the petitioner was completed and the final distribution of its remaining assets made. On July 6, 1937, pursuant to a resolution adopted at a special meeting of the stockholders held the preceding June 1, a certificate of dissolution was filed in the office of the Secretary of State of New York, and the petitioner was formally and legally dissolved on that date. Under the applicable provisions of New York law, the petitioner continues in existence for purposes of liquidating and winding up its affairs and may sue or be sued in its corporate name.

7. The complete liquidation of the petitioner described above complied with the provisions of Section 112 (b) (6) of the Revenue Acts of 1936 and 1938. Commercial Credit Company (Delaware), as the owner of 99.63% of all the outstanding shares of stock of the petitioner, has received in liquidation approximately that proportion of its net assets. Under said Section 112 (b) (6), no gain or loss is recognized to the Commercial Credit Company (Delaware) on this liquidation.

8. No part of the distributions received from petitioner by Commercial Credit Company (Delaware), as a stockholder, on December 30, 1936, was distributed in 1936 by Commercial
20 Credit Company (Delaware) as a taxable dividend to its shareholders within the meaning of Article 27 (f)-1 (c) of Regulations 94, and there was no apportionment, allocation, and payment as a dividend by Commercial Credit Company (Delaware) of any part of the sums so received as defined in that article.

9. Attached hereto and made a part hereof and marked "Exhibit 2" is a photostatic copy of a true and correct copy of the federal income tax return of Commercial Credit Company (Delaware) for the calendar year 1936. Such return was filed with the Collector of Internal Revenue for the District of Maryland.

10. Attached hereto and made a part hereof and marked "Exhibit 3" is a photostatic copy of a true and correct copy of petitioner's federal income tax return for the calendar year 1936.

DEAN G. ACHESON,
Dean G. Acheson,
Counsel for Petitioner,
701 Union Trust Bldg.,
Washington, D. C.

JACK J. LEVINSON,
Jack J. Levinson,
Counsel for Petitioner,
100 E. 42nd Street,
New York City.

J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Respondent.

(Exhibits to stipulation of facts omitted in printing. See stipulation appearing at fol. 81.)

40 Before United States Board of Tax Appeals

CREDIT ALLIANCE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 100561. Promulgated October 22, 1940

Petitioner, a corporation, distributed from earnings and profits accumulated since February 28, 1913, and in complete liquidation, approximately 99 percent of its assets to a corporation holding that percentage of its stock. Under section 112 (b) (6), Revenue Act of 1936, no gain or loss was recognized to the distributee. *Held*, that under section 27 (f), Revenue Act of 1936, the distribution to the parent corporation was properly chargeable to earnings or profits, and must be treated as a taxable dividend paid for the purpose of computing dividends paid credit without limitation by subsection (h) and in the calculation of tax upon un-

distributed net income it entitles the petitioner to credit in the amount of the distribution.

Dean Acheson, Esq., and W. Graham Clayton., Esq., for the petitioner. Joe D. Hughes, Esq., for the respondent.

This proceeding involves undistributed profits surtax for the year 1936. Deficiency was determined in the amount of $121,814.49, and error is asserted by the petitioner as to the entire amount.

Findings of fact

A stipulation of facts, including documentary exhibits attached thereto, was filed at the hearing and we find the facts as so stipulated. So far as pertinent to examination of the question propounded, they may be stated as follows:

The petitioner, a corporation, filed its Federal income tax return for 1936 with the collector for the District of Maryland. It was organized in 1922 under the law of New York and dissolved in July 1937. During its existence the petitioner was actively engaged in business. In 1930 the Commercial Credit Co., a Delaware corporation, acquired more than 80 percent of petitioner's outstanding capital stock and by December 1, 1936, owned 526,238 shares out of 528,186 shares outstanding, or 99.63 percent thereof. Its holding continued the same until cancellation of all stock, which took place beginning in 1936. In that year liquidation was decided upon, in order to simplify the corporate structure in accordance with section 112 (b) (6), Revenue Act of 1936,
41 and on December 1, 1936, the stockholders in special meeting, and later on the same day the directors, resolved to liquidate the corporation completely within three years, to distribute in liquidation property equivalent to $1.80 per share, to reduce the capital from $4,225,488 to $528,186, reducing the stated value of stock from $8 per share to $1 per share, and to distribute $7 per share in liquidation, all on December 10, 1936, to stockholders of record December 3, 1936. The resolutions were carried out, and out of earned surplus there were distributed to the stockholders cash and property, all of the value of $950,734.80. Thereof the Commercial Credit Co. received $947,228.40. The earned surplus account represented only earnings and profits accumulated since February 28, 1913; there was no paid-in surplus. On the same day petitioner, from assets made available by the reduction of capital from $4,225,488 to $528,186, distributed cash, and property all of the value of $3,697,302, of which the Commercial Credit Co. received $3,683,666. Further distributions were made in 1937 and final distribution was made and liquidation completed on November 30, 1938. Certification of dissolu-

tion had been filed in the office of the Secretary of State of New York on July 6, 1937, and the corporation legally dissolved on that date. The liquidation complied with the provisions of section 112 (b) (6), Revenue Act of 1936. The Commercial Credit Co. did not distribute in 1936 to its stockholders any of the distribution received by it from the petitioner on December 10, 1936, and did not apportion or allocate any part thereof to the petitioner.

Opinion

DISNEY: The question before us is: To what dividends paid credit is the petitioner entitled under the Revenue Act of 1936 because of distributions made by it in that year? Section 14 of that act imposes a tax upon "undistributed net income", to compute which it is necessary to deduct from net income (adjusted in other particulars not here important) the sum of the dividends paid credit. Section 27 (a) provides that such dividends paid credit shall be the amount of the dividends paid during the taxable year. Section 27, by subsections (f) and (h), provides as follows:

"(f) DISTRIBUTIONS IN LIQUIDATION.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

* * * * *

"(h) NONTAXABLE DISTRIBUTIONS.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

42 In the taxable year the petitioner distributed from its surplus earnings and profits and by way of complete liquidation cash and property of the value of $950,734.80, of which $947,228.46 or 99.63 percent of the distribution was received by a corporation owning the same percentage of its stock. Petitioner therefore contends that the amount distributed to the parent corporation is the basis for a dividends paid credit under the terms of section 27 (f); while respondent argues that under section 27 (h) the distribution does not constitute a dividends paid credit, for the reason that the distribution is not a "taxable dividend" because profit or loss is not recognized in the hands of the dis-

tributee, under the language of section 112 (b) (6) of the Revenue Act of 1936.[1]

1. The petitioner argues that subsection (f) is an exception to subsection (h); the respondent, that subsection (h) is a limitation upon subsection (f). The petitioner contends that it was the intent of Congress through section 112 (b) (6) to encourage liquidation of corporations in chains of holding companies and that to deny the dividends paid credit would nullify such encouragement; whereas the respondent contends that the prime object in the legislation was to force either the corporation or the distributee-stockholder to pay tax.

Excerpts from the committee reports can be found to bear out in some measure both views. We think it obvious that Congress had in mind both the idea of forcing the payment of tax upon corporate earnings and of encouraging liquidations of corporations forming parts of corporate chains. After reviewing the various committee reports on the subject, we have concluded that they are not inconsistent upon the present question, and that, considering the form of the legislation, it can be resolved by the application of the usual principles of interpretation.

With reference to such principles of interpretation, the petitioner urges that subsection (f) is a more particular subsection than subsection (h), and therefore under the familiar principle in that regard must control over subsection (h); while the respondent points out that subsection (h) is later than subsection (f) in the statute and therefore should be considered as an exception to subsection (f). We do not consider the latter principle of great weight. Though sometimes recognized, it is "a purely arbitrary rule of construction which is subject to the rule that the statute must be construed as a whole to find the legislative intent." 59 C. J. 1000. It has been called artificial, not inflexible, and to be resorted to only in extremis. People ex rel Mason v. McClane, 90 N. Y. 83; Commercial Trust Co. v. Hudson County Board of Taxation, 86 N. J. L. 424; 92 Atl. 263.

In Rodgers v. United States, 185 U. S. 83, the Court said:

"* * * So, when in section 13, Congress prescribed a general rule for the salaries of naval officers, such general rule cannot

[1] (6) PROPERTY RECEIVED BY CORPORATION ON COMPLETE LIQUIDATION OF ANOTHER.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except non-voting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property;

* * *

within the scope of this canon be understood as repealing the special provision in the prior section, but the special provision must be taken as an exception to and limitation of the general rule."

As indicated in Rodgers v. United States, supra, the common rule that a specific provision shall be held to control one more general is more salutary and stronger than the idea that the later of two provisions is the exception. We therefore consider the question whether subsection (f) or, on the contrary, subsection (h) is the more specific provision. Subsection (h) concerns itself with distributions in general, the subject matter being that any part of a distribution to confer dividends paid credit must be a taxable dividend. Subsection (f) concerns itself with distributions in liquidation, and the gist of the subject matter is that any part of a liquidation distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend paid. It seems to us wholly obvious that, on the face of the two subsections (f) is the more specific. Indeed, not only does it limit its effect to distributions in liquidation, patently a subdivision of "distributions" covered by subsection (h), but closer examination reveals that it is even more specific, for it involves, covers, and is effective upon not the entire distribution in liquidation, but only a specific part thereof, to wit, the part "which is properly chargeable to the earnings or profits," etc. We think it can not be denied that subsection (f) is the more specific subsection and that its language in general is to be given effect greater than that of subsection (h). Since in Rodgers v. United States, supra, the Court followed the more particular previous section rather than the later more general provision as to salaries of naval officers, we seem to be required here to consider and give effect to what is said in subsection (f) as to a certain part of a distribution in liquidation, rather than the language of subsection (h) as to distributions in general. The respondent calls our attention to the case of Centennial Oil Co. v. Thomas, 109 Fed. (2d) 359; certiorari denied, 309 U. S. 690, in which the majority opinion held that
44 "Subsection (h) modifies subsection (f) * * * by way of exception," and denies dividends paid credit for a distribution in liquidation under section 112 (b) (6). The petitioner takes sharp issue with the decision and urges us to follow the views expressed in an extensive dissenting opinion to the effect that subsection (f) is not in conflict with, or modified by, subsection (h) and confers dividends paid credit.

Examination of the majority view discloses that it relies, without discussion, upon the idea that subsection (h) modifies (f)

as an exception thereto and that, though a distribution in liquidation of profits will in general be treated as an ordinary taxable dividend, conferring dividends paid credit, credit is not to be allowed unless the distribution is a taxable dividend in the hands of the distributee. The conclusion of the court that subsection (h) is an exception to subsection (f), though urged upon us by the respondent here, is in contradiction of language used in the Treasury regulation propounded upon the subject.

Regulations 94, article 27 (f)–1, in part, recites:

To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27 (f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. * * *

We are of the opinion that the above language of the regulations is properly based upon that of the statute, not only because of the fact that the language in subsection (f) is more specific than that in subsection (h), but because the language of subsection (f) precludes the application of subsection (h) to it, if, as principles of statutory interpretation require, we give effect to all of the language of both subsections. Subsection (h) provides in effect that in order to confer dividends paid credit a distribution must be a taxable dividend in the hands of shareholders who are subject to taxation; but subsection (f) seems on its face designed to fulfill the requirement of "taxable dividend" in the case of a distribution in liquidation as to the part properly chargeable to earnings and profits, for it, with minute particularity, provides that such part of the liquidation distribution "shall * * * be treated as a taxable dividend paid." In other words, subsection (f) provides that the distribution complies with subsection (a) in that it shall be considered "paid" and further complies with subsection (h) in that it shall be treated as "a taxable dividend." To say, as does the respondent, that subsection (h) limits (f) and provides that although under the language thereof the distribution shall "be treated as a taxable dividend paid," it must, nevertheless, in order to confer dividends paid credit, be to the distributee "a taxable dividend," seems repetition without meaning, for subsection (f) has already provided that this particular type of distribution shall be treated as such taxable dividend. Not only so, but it shall be so treated "for the purposes of computing the dividends paid credit under this section." If subsection (f) does not entitle the distribution there involved to the dividends paid credit, it would seem useless to provide treatment of it for the purpose of computing such dividends paid credit. Computa-

tion thereof without allowance would be idle. If subsection (f) merely provided that the distribution there involved be "treated as a dividend," plainly subsection (h) would directly apply and credit would be denied if the dividend was not also taxable. But the same phrase which provides treatment of the distribution as a dividend requires treatment as taxable dividend. There is no opportunity for the distribution to be considered a dividend without being considered taxable and paid, and subsection (h), requiring a distribution to be taxable, has already been complied with, and is in that respect superfluous. In effect, respondent's view that subsection (h) must be applied to subsection (f) is tantamount to the view that subsection (f) merely provides that the distribution be considered a "dividend paid" and ignores the expression "taxable." Congress might well have so provided. A distribution in liquidation is not considered a dividend; Hellmich v. Hellman, 276 U. S. 233; and the object of subsection (f) in that regard is plain—to include in the category of "dividends" that which is not a dividend, to wit, a distribution in liquidation. Had Congress stopped there, that purpose would have been accomplished, and, as the respondent argues, distributions in liquidation (to the extent of the part "properly chargeable to the earnings or profits," etc.) would, though treated as dividends, still have been subject to the more specific requirement of subsection (h) that they be "taxable," and since under section 112 (b) (6) there is no recognition of gain or loss in case of the liquidation involved, the dividends paid credit would not have been allowable. But Congress did not stop at that point, but proceeded further to provide specifically that the treatment of the distribution should be also "as taxable," and, as if to close the matter completely, "paid" as well. Subsection (f) provides the specification "taxable" and (h) adds nothing in that regard.

Viewing all of the language of both sections as we must, and giving it ordinary significance, we come to the conclusion that subsection (f) is not modified by subsection (h), and, with all respect for the majority opinion in Centennial Oil Co. v. Thomas, supra, we differ with the conclusion there expressed.

Though our conclusion that subsection (h) does not modify or limit subsection (f) may be reached by considering subsection (f) as modifying the more general terms of subsection (h), we think that neither section modifies the other, but that they cover different ground. In our opinion, Congress by subsection
46 (h) intended to cover dividend distributions and to say that, if taxable, they confer dividends paid credit; and, separately, intended by subsection (f) to cover a different category, to wit, distributions in liquidation, and to say that, although not within the category of "dividends," they shall be treated so

as to confer dividends paid credit, to the limited degree provided in subsection (f). The fact that dividends and distributions in liquidation had been theretofore by the Supreme Court considered in different categories suggests a separation made by Congress between subsections (f) and (h), the one covering dividends, the other, to a limited degree, liquidation distributions, which would otherwise not receive treatment as dividends, for subsection (h) by its terms requires a distribution to be a "taxable *dividend*" (italics supplied) in order to gain the "dividends paid" credit. Subsection (h) does not cover the subject matter of subsection (f). Covering dividends, it may modify subsection (g) as to preferential *dividends* without modifying subsection (f), which embraces a different subject. Its use of the word "dividend" does not limit (f), but eliminates it from the category covered by (h). It is not without significance that subsection (h) includes and covers, by special parenthetic inclusion, subsection (e) as to stock dividends, but does not so include subsection (f). Subsections (e) and (f) both cover categories of distribution ordinarily viewed differently from ordinary dividends. Under the doctrine of *expressio unius exclusio alterius*, there is reason to believe that subsection (h) was definitely not intended to cover the subject matter of subsection (f).

2. However, the conclusion that subsection (h) does not limit subsection (f) does not settle the problem presented to us. The respondent contends, in effect, that subsection (f) confers dividends paid credit only as to that part of a distribution in liquidation which is "properly chargeable to the earnings or profits accumulated after February 28, 1913," that it is not properly chargeable if there is no recognition of profit or loss to the distributee, and that, since section 112 (b) (6) precludes such recognition, no dividends paid credit can be allowed. An interpretation of the expression "properly chargeable to the earnings or profits" is required of us. The petitioner's view is that only a distinction between charge to earnings or profits, or to capital, was intended by Congress; the respondent's attitude is based upon such cases as Commissioner v. Sansome, 60 Fed. (2d) 931; certiorari denied, 287 U. S. 667, which hold that if a corporate reorganization results in no recognition of profit or loss to the distributee corporation, as to earnings or profits of the distributor corporation, they remain for purposes of distribution "earnings or profits" of the distributee corporation, and do not become capital of the
47 distributee. The precise question in the Sansome case was whether a stockholder in both the distributor and the distributee corporation should, upon the liquidation of the distributee, be taxed upon what he received as a dividend or be allowed to apply against it the cost of his stock in the original corporation.

Under the then revenue act, a distribution in liquidation was taxable as a dividend and not as capital gain, to the extent of corporate earnings or profits. The court held the distribution to be from earnings and profits, though the distributee corporation had itself made no profit. Does the Sansome decision have bearing upon section 27 (f), Revenue Act of 1936, as to undistributed profits tax?

Our difficulty with the respondent's view is that it is not in accord with the usual significance of the term "properly chargeable" to the earnings and profits. We think it obvious that ordinary use and interpretation of the expression indicates what is paid or distributed out of earnings or profits, as contradistinguished from that which is distributed out of the capital, such as was done in the amount of approximately $3,700,000 in the liquidation here involved. That only a distinction between capital and earnings or profits is intended in section 27 (f) seems indicated by the language of section 115 (g) of the Revenue Act of 1936. Therein, with reference to distributions in redemption of stock essentially equivalent to the distribution of a taxable dividend, it is provided that the amount distributed shall be treated as a taxable dividend paid "to the extent that it *represents* a distribution of earnings or profits accumulated after February 28, 1913." (Italics supplied.) Patently, a distinction between capital and earnings or profits was intended. Was that not all that was intended in section 27 (f)? Again we find in section 115 (c) the provision that in case of distribution in partial liquidation the part of such distribution "which is properly chargeable to *capital account* shall not be considered a distribution of earnings or profits." (Italics supplied.) This seems, in the converse, to indicate the same distinction between capital account and earnings or profits, as herein involved. The same is true of section 113 (b) (1), having reference to adjustment of the basis for determining gain or loss. "Proper adjustment * * * shall in all cases be made * * * for expenditures, receipts, losses, or other items, *properly chargeable to capital account*." (Italics supplied.) It is obvious that in subsection (f) the language "the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913" eliminates earnings or profits accumulated prior to that date. It seems equally plain that Congress did not intend to confer dividends paid credit for a return of capital. The intent, in our opinion, went no farther. Indeed, Regulations 94, article 27 (f)-1 (*b*) states: "To determine the
48 amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account." The regulation goes on, however, to state that, "The

capital account, for purposes of these regulations, includes" amounts representing the value of the stock, the stockholder's share of paid-in surplus and "such other corporate items, if any, which for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock" and concludes that the remainder of the distribution in liquidation is properly chargeable to earnings and profits. Yet the respondent allowed the dividends paid credit upon the amount distributed to the minority stockholders—which amounts, of course, because distributed in liquidation "are applied against and reduce the basis of the stock" under section 115 (c), being "treated as in full payment in exchange for the stock." Thus we see that respondent's reason for a distinction between petitioner and the minority stockholders fails, and his position is seen to depend upon nontaxability of the distribution. The intent of the Revenue Act of 1936 in this matter is indicated by the report of the subcommittee to the Committee on Ways and Means (March 26, 1936), recommending the undistributed profits tax:

"In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account."

We think, therefore, that such cases as Commissioner v. Sansome, supra, do not suffice to demonstrate that under section 27 (f), and "for the purposes of computing the dividends paid credit under this section", there was no part of the distribution in liquidation "properly chargeable to the earnings or profits * * *." Cases considering reorganizations and "transfer of profits" intact, as respondent phrases the matter, do not convince that herein there was not distribution of profits, to a distributee in liquidation. Such cases as Commissioner v. Sansome, supra, consider and interpret different statutes and have to do with the position of a transferee corporation, not the distributing corporation, as here, and the fact that the distributee may be considered to be distributing its profits and not capital when it distributes the distribution in liquidation does not, in our opinion, for purposes of section 27 of the Revenue Act of 1936, determine the present question of dividends paid credit.

In arriving at this conclusion we do not disregard respondent's contention that the Revenue Act of 1938 added "property or money" to the language of section 115 (h) of the Act of 1936, to the effect that a nontaxable distribution of "stock or securities"
49 of the distributor or another corporation should not be considered distribution of earnings or profits. Respondent

argues that the 1938 Act merely clarifies the intent of that of 1936. We do not think that the latter act was a clarification. It seems, on the contrary, clearly an addition to what was not enacted in 1936. We therefore do not apply it to the transactions in 1936 here involved. Moreover, the fact that section 115 (h) provides that distribution of stock or securities shall not be considered distribution of earnings or profits if no gain to distributee is recognized, indicates that here, where stock or securities are not involved, the distribution under the general language of section 115 (b) "is made out of earnings or profits" regardless as to recognition of gain to the distributee.

The respondent says that there has been implied Congressional approval of its interpretation of section 27, inasmuch as Regulations 94, article 27 (f)–1, setting forth his view of the statute, was promulgated prior to the substantial reenactment of the 1936 statute in 1938. This is, of course, a "weight in the scale", Woolworth Co. 1. United States, 91 Fed. (2d) 973, but to be somewhat sparingly applied where the reenactment is not continued and the statute is later repealed, as herein in 1939. Moreover, it can not with accuracy be said there was reenactment without substantial change in 1938, since the undistributed profits tax was not continued in the legislation of that year. Considering the whole state of flux of the subject, we think we should give no great consideration, in construing the 1936 Act, to what was done in 1938, and undone in 1939.

Petitioner contends that the respondent's Regulations 94, article 27 (f)–1 (*c*), is without statutory authority. That section provides in effect that in case a corporation distributes in liquidation to another corporation its earnings or profits under section 112 (b) (6), any dividend paid by the transferee corporation later in the same year may be allocated to the transferor as a distribution of its earnings or profits. Inasmuch as herein petitioner's parent corporation-distributee paid no such dividends during the taxable year and no such allocation was made, we consider it unnecessary here to pass upon the validity of that portion of the regulation. Our conclusions above expressed signify that we consider as exceeding the statute Regulations 94, article 27 (f)–1 (*a*), (*b*), wherein there is in substance set forth the view of section 27 (f) which is advanced by the respondent herein.

We therefore conclude and hold that the petitioner is entitled to dividends paid credit in the amount of the distribution in liquidation to the Commercial Credit Co., to wit, $947,228.40, and that the respondent erred in disallowing same.

Reviewed by the Board.

Decision will be entered for the petitioner.

50 *Dissenting opinion*

BLACK, dissenting: I respectfully dissent from the majority opinion. I am unable to agree with the view that subsection (f) is not limited by subsection (h) of section 27, Revenue Act of 1936. My views in that respect harmonize with the views expressed in the opinion of the majority of the court in Centennial Oil Co. v. Thomas, 109 Fed. (2d) 359. Hence, I will only say that I think that case should be followed in our decision of the instant case.

TURNER agrees with this dissent.

51 Before United States Board of Tax Appeals
Washington

Docket No. 100561

CREDIT ALLIANCE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion promulgated October 22, 1940, it is

Ordered and decided: That there is no deficiency in undistributed profits surtax for the year 1936.

Enter:

(s) R. L. DISNEY, *Member.*

Entered Oct. 25, 1940.

52 In United States Circuit Court of Appeals
For the Fourth Circuit

B. T. A. Docket No. 100561

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER ON REVIEW

v.

CREDIT ALLIANCE CORPORATION, RESPONDENT ON REVIEW

Petition for review and assignments of error

Filed Jan. 17, 1941

To the Honorable Judges of the United States Circuit Court of Appeals for the Fourth Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Rev-

enue, and John W. Smith, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

JURISDICTION

That the petitioner on review is the duly appointed, qualified, and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, appointed and holding his office by authority of the laws of the United States; that the respondent on review, Credit Alliance Corporation, hereinafter referred to as the taxpayer, is a corporation incorporated under the laws of the State of New York in 1922, with its principal place of
53 business at Baltimore, Maryland, and filed its Federal income tax return (Form 1120) for the calendar year 1936 with the Collector of Internal Revenue for the District of Maryland, Baltimore, Maryland, whose office is within the jurisdiction of this Honorable Court; that the Court in which the review of this cause is sought is the United States Circuit Court of Appeals for the Fourth Circuit.

The Commissioner files this petition for review pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II

NATURE OF CONTROVERSY

The nature of the controversy is as follows, to wit:

In 1930 the Commercial Credit Company, a Delaware Corporation, acquired more than eighty per cent of taxpayer's outstanding capital stock and by December 1, 1936, owned 526,238 shares out of 528,186 shares outstanding, or 99.63 percent. Its holding continued the same until cancellation of all stock, which took place in 1936. In that year liquidation was decided upon in order to simplify the corporate structure. On December 1, 1936, the stockholders, in special meeting, and later on the same day, the directors, resolved to liquidate the corporation completely within three years. The resolutions were carried out and as a result the taxpayer distributed to its stockholders as a liquidating dividend in 1936, the total sum of $4,648,036.80, of which $950,734.80 represented earned surplus accumulated after Febru-
ary 28, 1913. Taxpayer's parent, the Commercial Credit
54 Company, received $4,630,894.40, of which $947,228.40 represented surplus accumulated from earnings after February 28, 1913. In its return for the year 1936, the taxpayer claimed the sum of $950,734.80 as a dividend paid credit for said year under subsection (a) of Section 27 of the Revenue Act of 1936, 49 Stat. 1648.

On August 9, 1939, the Commissioner mailed to the aforesaid taxpayer a notice of deficiency in Federal income tax for the calendar year 1936 in the amount of $121,814.49. In arriving at said deficiency the Commissioner determined that the amount of $947,228.40 received by taxpayer's parent, the Commercial Credit Company, did not constitute a dividend paid credit within the meaning of Section 27 of the Revenue Act of 1936 for the reason that the distribution was not a "taxable dividend" in the hands of the distributee under the provisions of Section 112 (b) (6) of the same Act.

On November 6, 1939, the taxpayer filed a petition with the United States Board of Tax Appeals appealing from the deficiency set forth in the notice of deficiency aforesaid, alleging that the Commissioner had erred in disallowing a dividend paid credit in the amount of $947,228.40 for the year 1936. The Commissioner filed his answer to the petition on December 9, 1939. The proceedings came on for hearing before a Division of the Board at Washington, D. C. on May 16, 1940. On October 22, 1940, the Board promulgated its opinion wherein it held that under Section 27 (f) of the Revenue Act of 1936, the distribution
55 of $947,228.40 to the parent corporation was properly chargeable to earnings or profits, and must be treated as a taxable dividend paid for the purpose of computing dividends paid credit, without limitation by subsection (h) of Section 27, and in the calculation of tax upon undistributed net income the taxpayer is entitled to credit in the amount of the distribution amounting to $947,228.40. On October 25, 1940, the Board entered its final decision wherein and whereby it ordered and decided that there was no deficiency in undistributed profits surtax for the year 1936.

III

ASSIGNMENTS OF ERROR

The Commissioner, being aggrieved by the conclusions of law contained in the decision of the United States Board of Tax Appeals and by its final order redetermining no deficiency in Federal income tax for the calendar year 1936, desires to obtain a review by the United States Circuit Court of Appeals for the Fourth Circuit.

The Commissioner's assignments of error are as follows:

1. The Board erred in failing to hold and decide that for the purpose of Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, the amount of $947,228.40, was not properly chargeable to earnings or profits accumulated after February 28, 1913.

2. The Board erred in holding and deciding that the distribution to the parent corporation, Commercial Credit Com-

56 pany, amounting to $947,228.40, was properly chargeable to earnings or profits accumulated after February 28, 1913, and that the taxpayer was entitled to dividends paid credit thereon.

3. The Board erred in failing to hold and decide that the amount of $947,228.40 was not allowable as a dividends paid credit under Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648.

4. The Board erred in not holding and deciding that the allowance of $947,228.40 as a dividends paid credit was prohibited by Section 27 (h) of the Revenue Act of 1936, 49 Stat. 1648.

5. The Board erred in holding and deciding that Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, is not modified by subsection (h) of the said Section 27.

6. The Board erred in holding and deciding that Section 27 (h) of the Revenue Act of 1936, 49 Stat. 1648, does not limit the provisions of Section 27 (f) of said Act.

7. The Board erred in entering its decision of redetermination that there is no deficiency in undistributed profits surtax for the year 1936.

8. The Board erred in failing and refusing to enter a decision of redetermination that there is a deficiency in undistributed profits surtax for the year 1936 in the amount of $121,814.49.

57 9. The Board erred in that its decision is not supported by the evidence.

10. The Board erred in that its decision is contrary to law and regulations.

Wherefore the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Fourth Circuit, that a transcript of record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court for filing, and that proper action be taken to the end that the errors complained of may be reviewed by said Court.

(Sgd.) SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
R. L. W.

(Sgd.) J. P. WENCHEL,
J. P. Wenchel,
R. L. W.
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN W. SMITH,
Special Attorney,
Bureau of Internal Revenue.
JWS; cm 1-16-41

58 [*Duly sworn to by John W. Smith; jurat omitted in printing.*]

59 In United States Circuit Court of Appeals for the Fourth Circuit.

[Title omitted.]

Notice of filing petition for review

Filed Jan. 23, 1941

To: CREDIT ALLIANCE CORPORATION,
First National Bank Building, Baltimore, Maryland.

You are hereby notified that the Commissioner of Internal Revenue did, on the 17th day of January, 1941, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fourth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 17th day of January, 1941.

(Signed) J. P. WENCHEL,
R. L. W.
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 18 day of January, 1941.

CREDIT ALLIANCE CORPORATION,
By (Signed) H. E. SPEARS,
Respondent on Review.

60 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Notice of filing petition for review

Filed Jan. 23, 1941

To: DEAN G. ACHESON AND WILLIAM G. CLAYTOR,
Union Trust Building, Washington, D. C.

You are hereby notified that the Commissioner of Internal Revenue did, on the 17th day of January 1941, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C.,

a petition for review by the United States Circuit Court of Appeals for the Fourth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 17th day of January, 1941.

(S) B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 22 day of January 1941.

(S) DEAN G. ACHESON,
(S) WILLIAM G. CLAYTOR,
Counsel for Respondent on Review.

61 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Statement of points

Filed April 10, 1941

Now comes Guy T. Helvering, Commissioner of Internal Revenue, the petitioner on review herein, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the following errors on which he intends to rely in this review:

1. The Board erred in failing to hold and decide that for the purpose of Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, the amount of $947,228.40 was not properly chargeable to earnings or profits accumulated after February 28, 1913.

2. The Board erred in holding and deciding that the distribution to the parent corporation, Commercial Credit Company, amounting to $947,228.40, was properly chargeable to earnings or profits accumulated after February 28, 1913, and that the taxpayer was entitled to dividends paid credit thereon.

3. The Board erred in failing to hold and decide that the amount of $947,228.40 was not allowable as a dividends paid credit under Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648.

4. The Board erred in not holding and deciding that the allowance of $947,228.40 as a dividends paid credit was prohibited by Section 27 (h) of the Revenue Act of 1936, 49 Stat. 1648.

62 5. The Board erred in holding and deciding that Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, is not modified by subsection (h) of the said Section 27.

6. The Board erred in holding and deciding that Section 27 (h) of the Revenue Act of 1936, 49 Stat. 1648, does not limit the provisions of Section 27 (f) of said Act.

7. The Board erred in entering its decision of redetermination that there is no deficiency in undistributed profits surtax for the year 1936.

8. The Board erred in failing and refusing to enter a decision of redetermination that there is a deficiency in undistributed profits surtax for the year 1936 in the amount of $121,814.49.

9. The Board erred in that its decision is not supported by the evidence.

10. The Board erred in that its decision is contrary to law and regulations.

J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within statement of points is hereby admitted this 9th day of April, 1941.

NEWELL W. ELLISON,
Counsel for Respondent on Review.

JWS:br 4/7/41.

63 In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted.]

Designation of portions of record, proceedings and evidence to be contained in the record on review

Filed April 10, 1941

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Fourth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of all proceedings before the Board.

2. Pleadings before the Board:

(a) Petition including copy of deficiency letter, Exhibit A, attached.

(b) Answer.

(c) Reply to Answer (not of record).

3. Stipulation of facts with Exhibits 1, 2 and 3 attached.

4. Findings of fact, opinion, and decision of the Board.

64 5. Petition for review together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

6. Statement of Points to be relied upon.

7. Orders enlarging time for transmission of the transcript of the record on review (not included in record).

8. This designation of portions of record, proceedings and evidence to be contained in the record on review.

Said transcript is to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Fourth Circuit.

J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within designation of portions of record, proceedings and evidence to be contained in the record on review is hereby admitted this 9th day of April, 1941. Agreed to:

NEWELL W. ELLISON,
Counsel for Respondent on Review.

JWS:br 4/7/41

65 [Clerk's Certificate to foregoing transcript omitted in printing.]

66 In the United States Circuit Court of Appeals for the Fourth Circuit

No. 4801

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

versus

CREDIT ALLIANCE CORPORATION, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

Docket entries

April 12, 1941, the transcript of record is filed and the cause docketed.

Same day, certified copy of order extending to April 17, 1941, the time for transmission and delivery of the record, is filed.

April 15, 1941, the appearance of Samuel O. Clark, Jr., Assistant Attorney General, and Sewall Key, Special Assistant to the Attorney General, is entered for the petitioner.

Same day, the appearance of Newell W. Ellison, Jack J. Levinson, and Christopher S. Sargent is entered for the respondent.

April 16, 1941, the appearance of J. P. Wenchel, Chief Counsel, and John W. Smith, Special Attorney, Bureau of Internal Revenue, is entered for the petitioner.

67 April 29, 1941, brief and appendix on behalf of the respondent are filed.

May 13, 1941, the appearance of Lee A. Jackson and Arthur A. Armstrong, Special Assistants to the Attorney General, is entered for the petitioner.

Same day, brief and appendix on behalf of the petitioner are filed.

ARGUMENT OF CAUSE

June 13, 1941 (June term, 1941), cause came on to be heard before Soper, Dobie, and Northcott, Circuit Judges, and was argued by counsel and submitted.

68 In United States Circuit Court of Appeals, Fourth Circuit

No. 4801

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

versus

CREDIT ALLIANCE CORPORATION, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

(Argued June 13, 1941. Decided July 21, 1941)

Before SOPER, DOBIE, and NORTHCOTT, Circuit Judges

Arthur A. Armstrong, Special Assistant to the Attorney General (Samuel O. Clark, Jr., Assistant Attorney General; Sewall Key and Lee A. Jackson, Special Assistants to the Attorney General, on brief) for Petitioner, and Newell W. Ellison (Jack J. Levinson and Christopher S. Sargent on brief) for Respondent.

Opinion

Filed July 21, 1941

69 SOPER, Circuit Judge: In the course of a complete liquidation in 1936, the Credit Alliance Corporation, the taxpayer, made a distribution to the Commercial Credit Company, its parent corporation, of earnings and profits accrued since February 28, 1913. No gain or loss resulted to the parent corporation from the distribution because of the provisions of Section 112 (b) (6) of the Revenue Act of 1936, 49 Stat. 648. The question in the pending case is whether the taxpayer is entitled, by reason of this liquidating distribution, to a dividends paid credit under Section 27 (f) of that Act, in the computation of the surtax on undistributed profits provided by Section 14 of that Act.

The facts as found by the Board of Tax Appeals are as follows: Credit Alliance Corporation, the taxpayer, was organized in July 1922 under the law of New York and dissolved in July 1937. During its existence it was actively engaged in business. In 1930 the Commercial Credit Company, a Delaware corporation, acquired more than 80% of the taxpayer's outstanding capital stock and by December 1, 1936, owned 526,238 shares out of 528,186 shares outstanding, or 99.63% thereof. Its holding continued the same until cancellation of all stock, which took place beginning in 1936. In that year liquidation of the taxpayer was decided upon, in order to simplify the corporate structure in accordance with Section 112 (b) (6), Revenue Act of 1936; and on December 1, 1936, the stockholders in special meeting, and later on the same day the directors, resolved to liquidate the corporation completely within three years, to distribute in liquidation property equivalent to $1.80 per share, to reduce the capital from $4,225,488 to $528,186, reducing the stated value of stock from $8 per share to $1 per share, and to distribute $7 per share in liquidation, all on December 10, 1936, to stockholders of record December 3, 1936. The resolutions were carried out,
70 and out of earned surplus there was distributed to the stockholders cash and property, all of the value of $950,734.80. Thereof the Commercial Credit Company received $947,228.40. The earned surplus account represented only earnings and profits accumulated since February 28, 1913; there was no paid-in surplus. On the same day the taxpayer, from assets made available by the reduction of capital from $4,225,488 to

$528,186, distributed cash and property all of the value of $3,697,302, of which the Commercial Credit Company received $3,683,666. Further distributions were made in 1937 and final disfribution was made and liquidation completed on November 30, 1938. Certification of dissolution had been filed in the office of the Secretary of State of New York on July 6, 1937, and the corporation legally dissolved on that date. The liquidation compiled with the provisions of Section 112 (b) (6) Revenue Act of 1936. The Commercial Credit Company did not distribute in 1936 to its stockholders any of the distribution received by it from the petitioner on December 10, 1936, and did not apportion or allocate any part thereof to the petitioner.

In its income tax return for 1936 the taxpayer claimed a dividends paid credit under Sections 14 and 27 of the Revenue Act of 1936 for the full amount of that year's distribution out of earnings and profits, that is, $950,734.80. The Commissioner allowed the credit to the extent of the amount distributed to minority stockholders, but disallowed it to the extent of $947,228.40, the amount distributed to the parent company. This resulted in the determination of a deficiency of $121,814.49 in taxpayer's undistributed profits tax for 1936. The taxpayer filed a petition for redetermination, and the Board of Tax Appeals held that there was no deficiency.

Section 14 (b) of the Revenue Act of 1936 imposes a surtax at graduated rates upon the undistributed profits of corporations. The tax is computed on such portions of the "undistributed net income" as are in excess of certain percentages of the "ad-
71 justed net income." The latter phrase is defined as "net income less normal income tax and certain specified credits." The phrase "undistributed net income" is defined as "the adjusted net income minus the sum of the dividends paid credit provided in Section 27," and another credit which has no bearing on this case.

We are concerned here with whether the earnings and profits distributed as aforesaid by the taxpayer to its parent corporation entitled the taxpayer to a dividends paid credit under the Act. Section 27 (a) defines the dividends paid credit as "the amount of dividends paid during the taxable year."

Section 27 (f) is a follows:

"(f) Distributions in Liquiation.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

On its face this section seems to support the claim of the taxpayer to a dividends paid credit equal to the amount distributed. But the Commissioner contends that the section is not applicable for two main reasons: First, it is said that Section 27 (f) is modified and limited by Section 27 (h) to situations in which the distribution is taxable in the hands of the distributee, and since under the provisions of Section 112 (b) (6), no taxable gain was recognized upon the receipt by the parent corporation of the property distributed in the pending case, the taxpayer was not entitled to dividends paid credit for that distribution.

Section 27 (h) and Section 112 (b) (6) are as follows:

"(h) Nontaxable Distributions.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are
72 subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part:"

"Sec. 112. Recognition of Gain or Loss.

"(b) Exchanges Solely in Kind.—

* * * * *

"(6) Property Received by Corporation on Complete Liquidation of Another. No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. * * *"

The government contends that Section 27 (f) must be construed in harmony with the general purpose of the Act to reach undistributed profits of a corporation by taxing them in its hands unless they are voluntarily distributed to the shareholders and become income in their hands subject to taxation; and that when Section 27 (f) is so interpreted, it does not cover a tax-free distribution from one corporation to another which does not involve a distribution of earnings for tax purposes.

This contention of the Commissioner met with the approval of the majority of the court in Centennial Oil Co. v. Thomas, 5 Cir., 109 F. 2d 361; but it was pointed out in the dissenting opinion that if effect is given to all of the language of both subsections, it will be seen that Section 27 (h) does not modify or limit Section 27 (f). In both sections the term "dividends paid credit" occurs. Section 27 (f) expressly provides that a liquidating distribution of earnings or profits shall be "treated as a taxable dividend paid," and hence such a distribution cannot be treated as a nontaxable distribution as to which, under Section 27 (h), no dividends paid credit is allowed. In the pending case the Board of Tax Appeals followed the interpretation of

the dissenting opinion. The Board held that Section 27 (h) is the more general and Section 27 (f) the more specific provision, and that Section 27 (f) should therefore control in
73. the case of a liquidating distribution, under the canon of statutory interpretation approved in United States v. Chase, 135 U. S. 260 and Rodgers v. United States, 185 U. S. 83. Ordinarily a liquidating distribution is not considered a dividend; Hellmich v. Hellman, 276 U. S. 233; M. E. Blatt Co. v. United States, 305 U. S. 267; but, by virtue of Section 27 (f), a liquidating distribution is to be treated not as a dividend but as a taxable dividend.

Confining ourselves for the moment to a comparison of these sections of the Act, we find we are in accord with the Board's interpretation. It gives effect to the coordinate purpose of the Act manifested in this section and also in Section 112 (b) (6) to encourage the simplification of corporate structures by liquidation. The desirability of such a simplification of corporate structures was stressed in a message of the President to the Congress on June 19, 1935, H. R. Rep. No. 1681, 74th Cong., 1st Sess., p. 4; and it was emphasized in the debates in Congress during the passage of the Revenue Act of 1936 by Senator George for the Senate Finance Committee on the floor of the Senate, and by Representative Doughton for the Ways and Means Committee on the floor of the House. See 80 Congressional Record 8799, 10270; Seidman, Legislative History of Federal Income Tax Laws, pp. 242, 243. Moreover, as we shall see, the Board's interpretation of Section 27 (f) is not inconsistent with the Congressional intent to tax undistributed corporate profits.

The Commissioner in the pending case places special reliance on the second reason above referred to. His argument is that a liquidating distribution of profits by a subsidiary to a parent corporation does not amount to a distribution "which is properly chargeable to the earnings or profits accumulated after February 28, 1913," in the words of Section 27 (f), because the property in the hands of the distributee still retains its character as earnings or profits as distinguished from capital. In other words, no distribution of profits has taken place. If, as in this case, no such taxable gain is recognizable in the transac-
74 tion, it is of obvious advantage to the government to distinguish a distribution from one entity to another in the same corporate structure from a distribution by a corporation to individual stockholders whose receipt of the property would be subject to an income tax. The argument finds its basis in the rule laid down in Commissioner v. Sansome, 2 Cir., 60 F. 2d 931, that if an intercorporate transfer of earnings and profits results

in no recognition of profit or loss to the distributee corporation, they remain earnings or profits, and do not become capital in its hands. In other words, a distribution of earnings in a tax-free transfer by a subsidiary to a parent does not turn the earnings into capital. See, also, Murchison's Estate v. Commissioner, 5 Cir., 76 F. 2d 641; Baker v. Commissioner, 2 Cir., 80 F. 2d 813.

This principle, however, does not necessarily lead to the Commissioner's conclusion. It is obvious that Congress may have used the term "earnings or profits" in Section 27 (f) in its customary sense, so as to provide that a distribution thereof in liquidation, as distinguished from a distribution of capital, should give rise to a dividends paid credit, and at the same time have provided in Section 112 (b) (6) that no gain or loss should be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. Indeed these sections read together adhere to the principle of Commissioner v. Sansome, supra, for they recognize that the property distributed remains in substantially the same hands and that no actual gain or loss has been realized in the transaction. Furthermore, if this interpretation is given, an obstacle to the simplification of corporate structures desired by Congress is removed.

We think that the term "earnings or profits" was used in Section 27 (f) to exclude from its purview a distribution of capital. We are of opinion, also, that the treatment of the distribution in this case as a taxable dividend paid will not
75 conflict with the purpose of Congress to impose a surtax upon undistributed corporate profits. It is true that a distribution of the property will relieve the taxpayer, the subsidiary corporation, from the payment of an undistributed profits tax, and the receipt of the property by the parent corporation will not require the imposition of a tax upon it for a gain received; but it is not true that the distributee will be under no liability for an undistributed profits tax upon the profit received if it remains undistributed in its hands. The distributor, having distributed the property, is free from the undistributed profits tax; the distributee, having received that which in another capacity it already possessed, is not required to pay a tax upon its formal receipt; but there is nothing in the Act which says that the distributee is not subject to a tax upon undistributed profits if it persists in the retention of property which, in its hands as in the hands of the former holder, retains its character as undivided profits. This interpretation has the undoubted advantage, that it gives to Sections 27 (f) and 27 (h) their normal meaning, and at the same time gives effect to the underlying

purposes of the Act to tax undistributed corporate profits and also to facilitate and encourage the simplification of corporate structures.

Having reached this conclusion, we have no need to pursue throughout its tortuous length the entire argument advanced by the Commissioner to show that Section 27 (f) should not be given the meaning which its language would ordinarily convey. The Commissioner's argument refers also to Section 115 (h) of the Act, which provides that a distribution to a distributee by a corporation of its stock or securities, or stock or securities in another corporation, shall not be considered a distribution of corporate earnings or profits if no gain to the distributee from the receipt of such stock or securities was recognized by law. It is said that this section is an express legislative recognition of the
76 principle of Commissioner v. Sansome, supra, as indeed it is,* and hence a similar restriction, although not expressed, should be implied in Section 27 (f) so that only those liquidating distributions which give rise to taxable gains in the hands of the distributee should be treated as taxable dividends paid.

In answer to this argument it is sufficient to say that the government adds no strength to its position by pointing out that Section 115 (h) of the Act of 1936 also involves a recognition of the principle of the Sansome case already considered above. Whether the same result would be reached under Section 115 (h) of the Act of 1938, which adds tax-free distributions of "property or money" to the category of transactions not to be considered as distributions of earnings or profits, we have no occasion now to consider. The reference to the transfer or exchange of "property" in Article 115 (h) of Treasury Regulations 94, promulgated under the Revenue Act of 1936, was obviously unauthorized if it was intended as an enlargement of the scope of the corresponding section of the act.

The government also refers, without avail, to Article 27 (f) of Treasury Regulations 94, which, without legislative sanction, authorizes a distributee in liquidation to allocate or transfer a dividends paid credit earned by it under the Act to its distributor. Indeed this regulation serves to indicate that the Treasury's interpretation of Section 27 (f) imposes so unreasonable a burden on the distributor in liquidation that some affirmative action to alleviate the consequences, at least in part, was required.

Our conclusion is that the decision of the Board of Tax Appeals should be affirmed.

*See Report of Senate Finance Committee, S. R. No. 2156, 74th Cong., 2d Sess., p. 91; Seidman, Legislative History of Federal Income Tax Laws, p. 260.

78 In United States Circuit Court of Appeals, Fourth Circuit

No. 4801

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CREDIT ALLIANCE CORPORATION, RESPONDENT

On Petition to Review the Decision of the United States Board of Tax Appeals

Judgment

Filed and Entered July 21, 1941

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, affirmed.

MORRIS A. SOPER,
U. S. Circuit Judge.
ARMISTEAD M. DOBIE,
U. S. Circuit Judge.
ELLIOTT NORTHCOTT,
U. S. Circuit Judge.

August 21, 1941, the mandate of this Court, in this cause, is issued and transmitted to the United States Board of Tax
79 Appeals, at Washington, D. C., in due form.

80 [Clerk's Certificate to foregoing transcript omitted in printing.]

81 In Supreme Court of the United States

October Term, 1941

No. 708

Stipulation concerning printed record

Filed Jan. 24, 1942

Subject to this Court's approval, it is hereby stipulated and agreed between the attorneys for the respective parties hereto,

that for the consideration of this case on writ of certiorari to the Circuit Court of Appeals for the Fourth Circuit granted November 24, 1941, the printed record may be shortened by substituting this stipulation for the three exhibits to the stipulation of facts filed with the Board of Tax Appeals in this case.

Exhibit 1 consists of a notice dated November 19, 1936, of a special meeting of the stockholders of the Credit Alliance Corporation to be held December 1, 1936, to take action on a proposed plan of liquidation of the corporation; and of the minutes of the special meeting held in accordance with the notice.

Exhibit 2 is the income and excess profits tax return for the calendar year 1936 of the Commercial Credit Company. That return reveals the following computations of income and undistributed profits tax:

82 INCOME TAX COMPUTATION

NORMAL TAX

13. Net income for income tax computation (item 29, page 2)			$11,812,303.10
15. Dividends received credit (85 percent of item 12 (a), page 2) (this credit not allowed to mutual investment companies)			5,006,250.90
17. Normal-tax net income (item 13 minus items 14 and 15 or 14 and 16)			$6,806,043.20
18. Tax on portion of item 17 not in excess of $2,000	Portion of Item 17 $2,000.00	Rate 8%	$160.00
19. Tax on portion of item 17 in excess of $2,000 and not in excess of $15,000	13,000.00	11%	1,430.00
20. Tax on portion of item 17 in excess of $15,000 and not in excess of $40,000	25,000.00	13%	3,250.00
21. Tax on portion of item 17 in excess of $40,000	6,766,043.20	15%	1,014,906.48
22. Total normal tax (amount of tax in items 18 to 21, inclusive)			$1,019,746.48

SURTAX ON UNDISTRIBUTED PROFITS

(See Instruction 32 respecting corporations exempt from surtax)

23. Net income for surtax computation (item 29, page 2)			$11,812,303.10
24. Less: Normal tax (item 22, above)			1,019,746.48
28. Adjusted net income (item 23 minus items 24-27)			$10,792,556.62
29. Less: Dividends paid credit (see Instruction 35)			9,804,241.77
31. Undistributed net income (item 28 minus items 29 and 30)			$988,314.85
Brought forward			$1,019,746.48
34. Tax on portion of item 23 not in excess of 20% of item 28	Portion of Item 33 $988,314.85	Rate 7%	$69,182.04

35. Tax on portion of item 33 in excess of 10% and not in excess of 20% of item 28	Portion of item 17	Rate	
	----------	12%	
83 36. Tax on portion of item 33 in excess of 20% and not in excess of 40% of item 28	----------	17%	
37. Tax on portion of item 33 in excess of 40% and not in excess of 60% of item 28	----------	22%	
38. Tax on portion of item 33 in excess of 60% of item 28	----------	27%	
39. Amount of tax in items 34 to 38, inclusive, $69,182.04.			
41. Total surtax (item 39 plus item 40)			$69,182.04
42. Total normal tax and surtax (item 22 plus item 41)			$1,088,928.52

Exhibit 3 is the income and excess profits tax return for the calendar year 1936 of the Credit Alliance Corporation. That return reveals the following computations of income and undistributed profits tax:

INCOME TAX COMPUTATION

NORMAL TAX

13. Net income for income-tax computation (item 29, page 2)			$699,687.63
17. Normal-tax net income (item 13 minus items 14 and 15 or 14 and 16)			699,687.63
18. Tax on portion of item 17 not in excess of $2,000	Portion of item 33 $2,000.00	Rate 8%	$160.00
19. Tax on portion of item 17 in excess of $2,000 and not in excess of $15,000	13,000.00	11%	1,430.00
20. Tax on portion of item 17 in excess of $15,000 and not in excess of $40,000	25,000.00	13%	3,250.00
21. Tax on portion of item 17 in excess of $40,000	659,687.63	15%	98,953.14
22. Total normal tax (amount of tax in items 18 to 21, inclusive)			$103,793.14

SURTAX ON UNDISTRIBUTED PROFITS

(See Instruction 32 respecting corporations exempt from surtax)

23. Net income for surtax computation (item 29, page 2)	$699,687.63	
24. Less: Normal tax (item 22, above)	103,793.14	
84 Total normal income tax (item 22) brought forward		$103,793.14
28. Adjusted net income (item 23 minus items 24–27)	$595,894.49	
29. Less: Dividends paid credit (see Instruction 35)	950,734.80	
31. Undistributed net income (item 28 minus items 29 and 30)	None	
41. Total surtax (item 39 plus item 40)		None
42. Total normal tax and surtax (item 22 plus item 41)		$103,793.14

It is further agreed that in the briefs for either party reference may be made to any portions of the exhibits to the stipulation of facts which are omitted from the printed record in accordance with this stipulation.

CHARLES FAHY,
Charles Fahy,
Solicitor General of the United States.

Dated this 20 day of January, 1942.

CHRISTOPHER S. SARGENT,
Counsel for Respondent.

Dated this 23 day of January, 1942.

84½ [File endorsement omitted.]

85 Supreme Court of the United States

Order allowing certiorari

Filed November 24, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 46036. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 708. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Credit Alliance Corporation. Petition for a writ of certiorari and exhibit thereto. Filed October 21, 1941. Term No. 708 O. T. 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1942

FILE COPY

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FILED
OCT 21 1941
CHARLES ELMORE CROPLEY
CLERK

No. 708

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CREDIT ALLIANCE CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CREDIT ALLIANCE CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above-entitled case on July 21, 1941.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 1–16) is reported at 42 B. T. A. 1020. The opinion of the Circuit Court of Appeals (R. 23–29) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 21, 1941. (R. 29–30.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1936 taxpayer corporation made a liquidating distribution of earned surplus to its parent corporation, which resulted in no taxable gain or loss to the parent because of Section 112 (b) (6) of the Revenue Act of 1936. For the purpose of computing undistributed profits surtax, is taxpayer entitled to a dividends paid credit under Section 27 (f) of the Revenue Act of 1936?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix.

STATEMENT

The facts were stipulated (R. 20–23) and found by the Board as stipulated (R. 1–3). They may be summarized as follows:

Taxpayer corporation was organized in 1922, under the laws of New York, and was dissolved in July 1937. As of December 1, 1936, Commercial Credit Company, a Delaware corporation, owned 99.63% of taxpayer's outstanding capital stock; that corporation continued to own the same percentage of the taxpayer's stock until the dis-

solution of the taxpayer was complete. (R. 2, 21.)

In 1936 liquidation of the taxpayer was decided upon. Most of its assets were distributed in 1936. Further distribution was made in 1937, and the final distribution was made, completing liquidation, on November 30, 1938. The 1936 distribution was carried out by reducing capital stock from $4,225,488 to $528,186. This reduced the stated value of each share from $8 to $1. The distribution upon each share was $7 from capital and $1.80 from earned surplus. The total distribution of earned surplus thus effected was $950,734.80, of which Commercial Credit Company received $947,228.40. (R. 2–3, 21–22.)

Commercial Credit Company did not redistribute to its own stockholders any part of the distribution received by it from the taxpayer in 1936 (R. 3, 22).

In its income tax return for 1936 the taxpayer claimed a dividends paid credit under Sections 14 and 27 of the Revenue Act of 1936 for the full amount of that year's distribution of earnings and profits, namely, $950,734.80. The Commissioner allowed the credit to the extent of the amount distributed to minority stockholders, but disallowed it to the extent of $947,228.40, the amount distributed to the parent company. This resulted in the determination of a deficiency of $121,814.49 in the taxpayer's undistributed profits tax for 1936 (R. 1). The taxpayer filed a petition for redetermination, and the Board of Tax Appeals held

that there was no deficiency (R. 17). The court below affirmed (R. 30).

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that taxpayer corporation was entitled, under Section 27 (f) of the Revenue Act of 1936, to a dividends paid credit for a tax-free liquidating distribution to its parent corporation.

REASONS FOR GRANTING THE WRIT

Taxpayer made a liquidating distribution of earned surplus to its parent corporation in 1936. Although the distribution was not a taxable dividend in the hands of the parent company by reason of Section 112 (b) (6) of the Revenue Act of 1936, taxpayer contends that it is entitled to a dividends paid credit in the amount of the distribution under the provisions of Section 27 (f) of the 1936 Act. Section 27 (f) provides as follows:

> In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

The Commissioner, on the other hand, contends that Section 27 (f) is limited by Section 27 (h), and that under the provisions of the latter section

the dividends paid credit was properly disallowed. Section 27 (h) provides as follows:

> If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

The Commissioner further contends that, even if Section 27 (f) is not limited by Section 27 (h), no dividends paid credit is allowable because the liquidating distribution made by the taxpayer in 1936 was not "properly chargeable to the earnings or profits" within the meaning of Section 27 (f).

1. The court below, in holding that Section 27 (f) is not limited by Section 27 (h) and that the taxpayer is therefore entitled to a dividends paid credit notwithstanding that the distribution was tax free, rendered a decision in direct conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359, on the identical question.[1] This Court denied the taxpayer's petition for cer-

[1] The decision in the *Centennial Oil* case may also have been rested in part upon the view that a tax-free distribution is not "properly chargeable to the earnings or profits" of the taxpayer within the meaning of Section 27 (f).

tiorari in the *Centennial Oil Co.* case (309 U. S. 690); at that time no other case involving the question had been decided. Since the decision in the instant case the Second Circuit has decided the same point against the Government in *Commissioner* v. *Kay Mfg. Corp.*, decided August 5, 1941, not officially reported but found in 1941 C. C. H., Vol. 4, par. 9635, in which a petition for a writ of certiorari is being filed contemporaneously with this petition.

2. The further holding of the court below that the 1936 distribution of earned surplus was "properly chargeable to the earnings or profits" of the taxpayer within the meaning of Section 27 (f) appears inconsistent in principle with the decisions in *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2), certiorari denied, 287 U. S. 667; *United States* v. *Kauffman*, 62 F. (2d) 1045 (C. C. A. 9); and *Marchison's Estate* v. *Commissioner*, 76 F. (2d) 641 (C. C. A. 5). These cases establish that distributions of property by a corporation which, under Section 112 of the 1936 Act and the corresponding provisions of earlier Acts are received by the shareholder without the recognition of gain or loss, are not to be regarded as a distribution of earnings or profits for purposes of Section 115. Upon like principle, such a tax-free distribution of property should not be regarded as properly chargeable to earnings or profits for purposes of Section 27 (f).

It was in this view that the Treasury promulgated Article 27 (f)–1 of Regulations 94, providing that no dividends paid credit is allowable under Section 27 (f) with respect to distributions, such as the one here involved, which are tax-free under Section 112 and are, therefore, not regarded as a distribution of earnings or profits for purposes of the Act. In the light of the *Sansome* and other cases cited above, and of the fact that the theory of the regulation subsequently received legislative approval,[2] the regulation cannot be considered unreasonable. Under the controlling decisions of this Court, therefore, the regulation should have been given effect. *Helvering* v. *Reynolds*, 313 U. S. 428; *Morgan* v. *Commissioner*, 309 U. S. 78,

[2] Section 115 (h) (1) of the Revenue Act of 1938, which is a broadened version of Section 115 (h) (1) of the 1936 Act, specifically provides that the "distribution (whether before January 1, 1938, or on and after such date) to a distributee by or on behalf of a corporation of its stock or securities * * * or of property or money, shall not be considered a distribution of earnings or profits of any corporation * * * if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law * * *." This provision seems clearly applicable to Section 27 (g) of the 1938 Act, which is identical with Section 27 (f) of the 1936 Act, except that it is applicable only to the computation of surtax on improperly accumulated surplus and on personal holding company income, the undistributed profits tax having been repealed. See *Reed Drug Co.* v. *Commissioner*, 44 B. T. A. 573. The Committee reports make clear that the purpose of the amendment of Section 115 (h) (1) was to clarify and not to change the existing law. S. Rep. No. 2156, 74th Cong., 2d Sess., p. 19; S. Rep. No. 1567, 75th Cong., 3d Sess., pp. 18–19.

81; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Helvering* v. *Winmill*, 305 U. S. 79.

3. The precise question at issue here is involved in a number of pending cases,[3] which are being held in abeyance until the present case is disposed of, or which by stipulation are to abide the outcome of the present case.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition should be granted.

CHARLES FAHY,
Acting Solicitor General.

OCTOBER 1941.

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[3] Among these are *Commissioner* v. *Ashville Citizen-Times Co.* (C. C. A. 4th); *Commissioner* v. *Biltmore Co.* (C. C. A. 4th); *Commissioner* v. *Avalon Paper Co.*, and related cases (C. C. A. 9th); *Commissioner* v. *California Brewing Assn. and Acme Breweries* (C. C. A. 9th); *Commissioner* v. *Desmond's Co.* (C. C. A. 9th); *Commissioner* v. *O'Donnell Oil & Securities Co.* (C. C. A. 9th); *Commissioner* v. *Oliver Ditson Co.* (C. C. A. 1st); and *Little Gem Coal Co.* v. *Commissioner*, 44 B. T. A. 755.

APPENDIX

Revenue Act of 1936, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

* * * * *

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * * * *

(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall,

for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

* * * * * *

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * *

(b) *Exchanges Solely in Kind.*—

* * * * * *

(6) PROPERTY RECEIVED BY CORPORATION ON COMPLETE LIQUIDATION OF ANOTHER.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater per-

centage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

* * * * * *

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or * * *

* * * * * *

Revenue Act of 1938, 52 Stat. 447:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 27 (f)-1. *Dividends paid credit for distributions in liquidation.*—(a) *Distributions which diminish earnings or profits.*—To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27 (f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Act as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if—

(1) Under the provisions of section 115 (c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, a dividends paid credit is allowable for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.*—In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the

amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.*—If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of the transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the pur-

poses of the dividends paid credit, any such distribution so allocated shall be treated as a dividend paid only in the computation of the credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as a part of its returns for the taxable year involved, (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No dividends paid credit based upon such apportionment and allocation will be allowed unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph.

U. S. GOVERNMENT PRINTING OFFICE : 1941

No. 708

In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CREDIT ALLIANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

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No. 708

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CREDIT ALLIANCE CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13–24) is reported at 42 B. T. A. 1020. The opinion of the Circuit Court of Appeals (R. 32–38) is reported at 122 F. (2d) 361.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 21, 1941 (R. 39). The petition for a writ of certiorari was filed on October 21, 1941, and granted on November 24, 1941 (R. 42). The

jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1936 the taxpayer corporation made a liquidating distribution of earned surplus to its parent corporation, which resulted in no taxable gain or loss to the parent corporation under Section 112 (b) (6) of the Revenue Act of 1936. For the purpose of computing undistributed profits surtax, is taxpayer entitled to a dividends paid credit under Section 27 (f) of the Revenue Act of 1936?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra*, pp. 37–58.

STATEMENT

The facts were stipulated and found by the Board as stipulated (R. 10–12, 14). They may be summarized as follows:

Taxpayer corporation was organized in 1922, under the laws of New York, and was formally dissolved in July 1937. Commercial Credit Company,[1] a Delaware Corporation, owned 99.63 percent of taxpayer's outstanding capital stock on December 1, 1936, and continued to own the same percentage until taxpayer was dissolved. (R. 10–11).

[1] Hereinafter referred to as the parent corporation.

Dissolution and liquidation of taxpayer corporation was decided upon in 1936 and carried out during the years 1936 to 1938, inclusive (R. 11–12). In 1936 taxpayer made a distribution in liquidation of $8.80 a share (R. 11). Of this amount $1.80 a share or a total of $950,734.80 was distributed out of earned surplus (R. 11); the minority stockholders received .37 percent of that amount or $2,506.40, and the parent corporation, Commercial Credit Company, 99.63 percent or $947,228.40 (R. 11).

To the extent that the minority stockholders received more than they had paid for their stock and under familiar provisions of the Revenue Acts they were taxed on their gains in accordance with the general rule. See Revenue Act of 1936, Sections 111, 112, 115. Section 112(b), however, made certain exceptions to the general rule, one of which applied to the parent corporation. Section 112(b) (6), provided that no gain or loss should be recognized to a corporation which received property in complete liquidation of a subsidiary in which it had had 80 percent ownership and control. Because of its preponderant stock ownership in taxpayer, therefore, any gain or loss which the parent corporation may have realized upon the receipt of taxpayer's assets in liquidation was not recognized for tax purposes (R. 12). And since the parent corporation did not distribute to its shareholders the assets so received (R. 12), the current earnings which were distributed to the parent were never the subject of the income tax.

In addition to the income tax, the Revenue Act of 1936 imposed upon corporations an undistributed profits surtax for the very purpose of reaching and taxing corporate earnings which were not distributed so as to be taxed to the stockholders. A graduated surtax was levied upon "undistributed net income". Section 14. "Undistributed net income" was to be calculated by making minor adjustments to the ordinary corporate net income and subtracting two credits: (1) a credit for sums required to be set aside by certain contracts restricting the payment of dividends and (2) a "dividends paid credit" for certain corporate distributions specified in Section 27, which may be generally characterized as distributions on which the shareholders would be subject to tax. Section 27 (f) dealt specifically with distributions in liquidation, such as taxpayer made, and allowed a dividends paid credit for "the part of such distribution which is properly chargeable to earnings or profits accumulated after February 28, 1913." The Treasury regulation promulgated under this section pointed out that there was a "distribution of earnings" in the tax sense only when a gain or loss was recognized under section 112, and therefore expressly denied a credit for amounts distributed in liquidation by a subsidiary to a parent which owned more than 80 percent of its stock, unless the parent in turn distributed the amounts to its shareholders as

dividends, in which case the credit was allowed. Also Section 27(h) provided:

> *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

As stated above, the parent corporation by virtue of Section 112 (b) (6) was not taxed upon any gain which it may have realized upon liquidation of taxpayer and did not declare any dividends on account of the property which it received. The taxpayer, nevertheless, in computing its undistributed profits surtax for the year 1936, claimed a "dividends paid credit" for the full amount of the distribution out of earned surplus, $950,734.80 (R. 4).

The Commissioner allowed the credit to the extent of the amount distributed to the minority stockholders but disallowed it to the extent of $947,228.40, the amount distributed to the parent corporation (R. 7). Accordingly, the Commissioner determined a deficiency of $121,814.49 in taxpayer's undistributed profits surtax for 1936.

Taxpayer filed a petition for redetermination. Before the Board of Tax Appeals the Commissioner contended that the latter amount was not a

"distribution * * * properly chargeable to the earnings or profits" of taxpayer within the meaning of Section 27 (f) even though it was charged to post-1913 earnings on the taxpayer's books,[2] on the ground that under Section 112 (b) (6) the distribution was not one upon which a gain was recognized to the parent corporation; and he also urged that Section 27 (h) forbade the credit because the distribution was not "a taxable dividend in the hands of * * * the shareholders."

The Board of Tax Appeals held that there was no deficiency (R. 24). The court below affirmed (R. 39).

The decision below conflicts with *Centennial Oil Co.* v. *Thomas,* 109 F. (2d) 359 (C. C. A. 5th), certiorari denied, 309 U. S. 690, the Court brought the case here. The same question was decided adversely to the Commissioner in *Commissioner* v. *Kay Mfg. Corp.,* 122 F. (2d) 443 (C. C. A. 2d), now pending in this Court on petition for a writ of certiorari as No. 709, this Term.

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that taxpayer corporation was entitled, under Section 27 (f) of the Revenue Act of 1936, to a dividends paid credit for the tax-free liquidating distribution to its parent corporation.

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[2] Since taxpayer was formed in 1922 it is undisputed that all of its earnings were accumulated after February 28, 1913.

SUMMARY OF ARGUMENT

Article 27(f)–1(a) of Treasury Regulations 94 flatly denies the dividends paid credit which taxpayer seeks, on the ground that no gain or loss was recognized to the parent corporation under Section 112 (b) (6). Section 112 (b) (6) provides that no gain or loss shall be recognized for tax purposes when a subsidiary distributes its assets in liquidation to a parent corporation owning a preponderant part of its stock. Underlying Section 112 (b) (6) is the concept that in those circumstances there has been no real distribution or division of the earnings of the enterprise despite the formal transfer from one corporate form to another. Taxpayer and its parent corporation took advantage of this rule. Article 27(f)–1(a) does no more than apply the same principle in determining whether there has been a "distribution * * * chargeable to the earnings" within the meaning of Section 27 (f). If this Treasury interpretation is at all reasonable, it must be sustained.

The purpose of the undistributed profits surtax was to levy upon all corporate earnings which were not distributed so as to be taxable to the individual shareholders. In drafting Section 27 (f), therefore, Congress was required to correlate it with Section 112 and other sections determining what distributions in liquidation were taxed in the hands of the shareholders. The phrase "distribution

chargeable to earnings and profits accumulated after February 28, 1913" was a suitable formula for this purpose; in tax law as distinguished from accounting, it had been used as not only excluding distributions chargeable to capital or to pre-1913 earnings but as also excluding transfers of earned surplus accompanying a mere change in corporate form of the kind required to be ignored by Section 112 and kindred sections. When the Revenue Act of 1936 was enacted, Congress showed that it knew and approved this usage. When the Revenue Act of 1938 was enacted, Congress declared in Section 115 (h) that the term should be considered to have been used in its tax sense throughout the Act and it was expressly stated in the committee reports that no change in existing law was thereby intended. At the same time Section 27 (f) was reenacted without change as Section 27 (g) of the 1938 Act. Thus Congress twice gave approval to the interpretation expressed in Article 27(f)-1(a) of the 1936 regulations.

Section 27 (h) declares that no dividends paid credit shall be allowed for distributions which are not "taxable dividend[s] in the hands * * * of the shareholders * * *." It is a general subsection with the caption *"Nontaxable Distributions"* and is intended to require the preceding subsections in Section 27 to be interpreted consistently with the purpose of the Act to subject all corporate earnings to tax either in the hands of

shareholders or as undistributed profits. The word "dividend" must be read in conjunction with the caption *"Nontaxable Distributions"* as including a liquidating dividend. Thus, Section 27 (h) states the obverse of Section 27 (f) and shows the Treasury's interpretation of Section 27 (f) to be correct.

The strongest case which taxpayer can make is that Section 27 (f) may use the term "distribution chargeable to earnings and profits" in the accounting sense. But it cannot be denied that Congress knew and approved using the phrase with the tax meaning which the Treasury attributes to the words, nor can it be gainsaid that the regulation carries out the purposes of the undistributed profits tax in a just and reasoned manner. In such circumstances the regulation is controlling.

ARGUMENT

TAXPAYER IS NOT ENTITLED TO A CREDIT IN COMPUTING ITS UNDISTRIBUTED PROFITS SURTAX FOR THE TRANSFER OF ITS EARNED SURPLUS IN LIQUIDATION TO A PARENT CORPORATION OWNING 80 PER CENT OF ITS CAPITAL STOCK

The Board and the court below decided the case as if no Treasury regulation were involved; they held, in effect, that Section 27 (f) should be read to allow a credit for all distributions in liquidation which were chargeable to earned surplus on the corporate books, and that read in this manner, Section 27 (f) controlled the somewhat inconsistent pro-

visions of Section 27 (h), even though no gain or loss upon the liquidation was recognized to the parent corporation. We submit that the Board and the court below erred. We shall show (1) that under the applicable Treasury regulation taxpayer was not entitled to the credit claimed; (2) that the words "distribution * * * chargeable to earnings and profits," which appear in Section 27 (f), are words of art used to include only distributions which result in a taxable gain or loss to the distributee and to exclude the transfers of earned surplus occurring in a change of corporate form unaccompanied by any change in substantial ownership and control; (3) that Section 27 (h) shows that this is the true meaning of Section 27 (f); and (4) that since the applicable regulation is in any event a reasonable interpretation of Section 27 (f), it must be sustained.

1. UNDER THE APPLICABLE TREASURY REGULATIONS A SUBSIDIARY CORPORATION IS NOT ENTITLED TO A DIVIDENDS PAID CREDIT FOR DISTRIBUTIONS IN LIQUIDATION TO ITS PARENT CORPORATION ON WHICH NO TAXABLE GAIN OR LOSS IS RECOGNIZED UNDER SECTION 112 (b) (6)

The 1936 transfer of earned surplus from taxpayer to its parent corporation did not result in a taxable gain or loss to the latter. Revenue Act of 1936, Section 112 (b) (6). The parent corporation took taxpayer's basis for all tax purposes in connection with any property distributed in kind. Section 113 (a) (15). The tax effect of the trans-

fer (or distribution in liquidation) was quite different, therefore, from its effect upon the corporate books, for according to ordinary accounting concepts taxpayer had distributed its earnings and the parent corporation had realized a gain or loss upon its investment in taxpayer's stock. Thus, the accountant gives effect to the change of corporate form whereas Section 112 (b) (6) (and companion provisions dealing with similar corporate reorganizations) is framed upon the practical realization that no real division or distribution of the profits of the enterprise occurs when a subsidiary liquidates by transferring its assets and surplus to a parent corporation owning a preponderant part of its stock.

Despite these circumstances taxpayer seeks a "dividends paid credit" for the distribution in liquidation to its parent corporation, on the ground that accounting standards must be used in applying the phrase in Section 27 (f), "distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913 * * *."

The applicable Treasury regulation, however, flatly denies the credit which taxpayer seeks. Article 27 (f)–1 (a) of Treasury Regulations 94 states that a distribution in complete or partial liquidation of a corporation is treated by the Revenue Act as a distribution properly chargeable to earnings only if "under the provisions of section 112, the

gain or loss, if any," realized by the shareholders "is recognized" for tax purposes. It provides:

> * * * certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. *No dividends paid credit is allowable with respect to such transactions.* [Italics added.]

Article 27 (f)–1 (c) allows a credit to be claimed for the subsidiary if the parent corporation in the same year passes the earnings on to its shareholders so that a real distribution is made.

Reduced to their essential meaning these provisions of Article 27 (f)–1 require only that the changes in corporate form which Congress declared insignificant for tax purposes in Section 112 shall also be ignored in applying Section 27 (f). Unless this interpretation is so unfaithful to the statute as to be unauthorized, the decision below must be reversed. The regulation was promulgated in a field of great technical difficulty requiring novel pro-

visions to be woven into interrelated sections of unusual complexity so as to achieve harmonious administration. In such circumstances and in view of the fact that the Treasury participated in drafting the act, the Treasury regulation should be sustained, if at all reasonable. *United States* v. *Joliet & Chicago R. R.*, No. 151, this Term, decided January 19, 1942; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *Spring City Co.* v. *Commissioner*, 292 U. S. 182, 189; cf. *Textile Mills Securities Corp.* v. *Commissioner*, No. 34, this Term, decided December 8, 1941.

2. THE PURPOSES OF THE UNDISTRIBUTED PROFITS SURTAX AND THE HISTORY OF THE PHRASE "DISTRIBUTION CHARGEABLE TO EARNINGS AND PROFITS" SHOW THAT THE APPLICABLE REGULATION INTERPRETS SECTION 27 (f) CORRECTLY

The broad plan of the Revenue Act of 1936 was to tax distributed corporate earnings in the hands of individual shareholders and to surtax undistributed earnings to corporations. This would place their fair share of the burden upon investors who could afford to leave earnings undistributed in the corporate treasury. See Message of the President to Congress, March 3, 1936, H. Doc. 418, 74th Cong., 2d Sess., pp. 2–3; H. Rep. 2475, 74th Cong., 2d Sess., pp. 3–5. To carry out the first branch of the plan, taxes upon individual shareholders were in-

creased by subjecting dividends to the normal tax.[3] To carry out the second, the undistributed profits surtax was generally levied for the first time upon the "undistributed net income" of corporations,[4] including undistributed income accruing from dividends by other corporations. Sections 14, 21, cf. Sections 13 (a) (2), 26 (b). Stated simply, the surtax was levied upon an amount (called "undistrib-

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[3] Theretofore dividends had been exempt from the normal tax upon individuals. See, *e. g.*, Revenue Act of 1934, c. 277, 48 Stat. 680, Section 25 (a) (1), allowing a credit for such dividends. This provision was omitted from the 1936 Act.

[4] The new plan was plainer in the form in which the Revenue Bill of 1936 (H. R. 12395, 74th Cong., 2d Sess.) passed the House and reached the Senate than it was in the bill as it became law. The House bill subjected dividends to the normal tax when received by individuals but provided for no normal income tax on corporations. There was a graduated tax which could be entirely avoided if the entire adjusted net income of a corporation was distributed, but which began to be imposed if as little as 1 percent was retained. In the law as finally enacted a normal tax upon corporate income was restored (Section 13) and combined with a surtax on undistributed income (Section 14).

Earlier undistributed profits tax provisions had penalized the accumulation of corporate earnings for the express purpose of avoiding surtaxes upon the individual shareholders. Revenue Acts of 1921, c. 136, 42 Stat. 227, 1924, c. 234, 43 Stat. 253, and 1926, c. 27, 44 Stat. 9, Section 220 (a); Revenue Acts of 1928, c. 852, 45 Stat. 791, and 1932, c. 209, 47 Stat. 169, Section 104 (a); Revenue Acts of 1934, c. 277, 48 Stat. 680 and 1936, c. 690, 49 Stat. 1648, Section 102 (a). Cf. Income Tax Act of 1913, c. 16, 38 Stat. 166, Section II A, subdivision 2; Revenue Act of 1916, c. 463, 39 Stat. 756, Section 3; Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 220. Also the undistributed income of personal holding companies had been surtaxed. Revenue Acts of 1934 and 1936, Section 351.

uted net income") calculated by making adjustments to the ordinary corporate net income[5] and then subtracting a "dividends paid credit" for distributions to shareholders. Sections 14, 27. Consequently, in drafting the Act the critical provisions were those defining the corporate distributions on account of which a "dividends paid credit" could be deducted. To execute the plan successfully they would have to be woven into the existing framework of the Revenue Acts and into the whole body of tax law so that the credit would be allowed for all distributions normally taxed to their recipients and denied for those which were tax free.

Section 27 (f) was one of these critical provisions for its purpose was to define the distributions in liquidation for which a credit should be allowed. Such distributions were not "dividends" in the tax sense. See Sec. 115 (c); *Hellmich* v. *Hellman*, 276 U. S. 233. But to the extent that they represented current net earnings, their division among the shareholders would normally result in the receipt by the latter of taxable gains, and in such cases allowance of a credit to the liquidating corporation would be within the ambit of the scheme.[6] On the

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[5] The principal adjustment is a credit for sums required to be set aside by certain contracts restricting the payment of dividends. Section 26 (a).

[6] One hundred per cent of such gains is taxable to the shareholders if the liquidation is only partial, and to corporate shareholders even if the liquidation is complete. The gain received by an individual from a distribution in complete liquidation is wholly or partly taxed, depending upon the period for which the stock has been held; the percentage

other hand, a distribution from one corporation to another even of earnings accumulated after 1913 would not result in a tax if the transfer were so formal that Section 112 required it to be ignored, as, for example, in the present case. Faithfulness to the purposes of the Act, therefore, would require the credit in these latter instances to be denied under Section 27 (f) by using words which correlated that section with Section 112.

To achieve the requisite correlation, Congress deliberately chose the words "distribution * * * chargeable to earnings and profits accumulated after February 28, 1913." They had acquired through judicial decision and congressional usage a well understood tax meaning as applied to distributions in liquidation; specifically, they carried with them in addition to their accounting meaning the concept underlying Section 112, that the tax law should ignore mere changes in cor-

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ranges from one hundred per cent for a holding period of a year or less down to thirty per cent for a holding period of more than ten years. Sections 115 (c), 117. One purpose of these percentage provisions was to "give a proper recognition to the length of time during which the profit or loss has accrued." See the remarks of Senator Harrison, Chairman of the Senate Finance Committee, 78 Cong. Rec. 5846. Cf. *Helvering* v. *Hammel*, 311 U. S. 504. The object was to tax a part of the gain which was commensurate with the current accrual of gain. That part of the distribution attributed to current earnings in computing the undistributed profits tax may be considered to be included in the part taxed as a gain to the shareholders for, by hypothesis, it accrued currently.

porate form and should not recognize for tax purposes whatever "distribution" may be said to take place for accounting purposes when earned surplus is transferred intact from one corporation to another under the same ownership and control.

Commissioner v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2d), certiorari denied, 287 U. S. 667, is the leading case. The assets of one corporation had been transferred to a new corporation in exchange for the issuance of the latter's shares to the stockholders of the first. By ordinary accounting principles the old corporation received the stock of the new corporation, and distributed it to its stockholders, thereby effecting a liquidating distribution of capital and earnings. All its former assets became capital of the new corporation and a subsequent distribution of any part of them to the shareholders of the new corporation was by accounting standards a proper charge to capital account. Nevertheless, the court held that the subsequent distribution by the new corporation was a "distribution of earnings and profits" because the reorganization did not affect the status of the earnings and profits of the old corporation for tax purposes. The court's view was that the sections which permitted the reorganization to be accomplished without recognition of gain or loss to the transferee required the venture to be treated as uninterrupted for other tax purposes notwithstanding the change in corporate form. Necessarily the *Sansome* case also decided that the

liquidation of the old corporation did not result in a "distribution of earnings and profits" in the tax sense; otherwise they would not have remained intact for distribution to the shareholders of the new corporation.

The *Sansome* decision, of course, was not limited to its particular facts. In the presence of a specific provision which was inapplicable because it stated only a part of the principle,[1] the *Sansome*

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[1] There had been provisions in the Revenue Act of 1934 and prior acts, applicable to transactions before January 1, 1934, that tax-free reorganization distributions of securities should not be deemed distributions of earnings for the purpose of determining the taxability of subsequent distributions by the same corporation. Revenue Act of 1934, c. 277, 48 Stat. 680, Section 115 (h); Revenue Acts of 1932, c. 209, 47 Stat. 169, and 1928, c. 852, 45 Stat. 791, Section 112 (h); Revenue Acts of 1926, c. 27, 44 Stat. 9, and 1924, c. 234, 43 Stat. 253, Section 203 (g). This provision was aimed primarily at the case where corporation A transfers some of its assets to B for the latter's stock which is distributed to A's stockholders without retiring A's stock. Prior to 1934 such a distribution was tax free. Revenue Acts of 1932 and 1928, Section 112 (g); Revenue Acts of 1926 and 1924, Section 203 (c). It was not tax free under the 1934 Act. Cf. H. Rep. No. 704, 73d Cong., 2d Sess., p. 14 (1939-1 Cum. Bull. (Part 2) 554, 564); S. Rep. No. 558, 73d Cong., 2d Sess., p. 16 (1939-1 Cum. Bull. (Part 2), 586, 598). It is for this reason that Section 115 (h) of the 1934 Act is stated to apply only to distributions before January 1, 1934. See H. Rep. No. 704, *supra*, pp. 26-27. S. Rep. No. 558, *supra*, p. 33. Thus, specific provisions applicable to the transferor had been in force for some years prior to the *Sansome* case and decisions following it. These cases, however, dealt primarily with the earnings of the transferee corporation, and held without benefit of any similar provision that the earnings were enhanced by what had been the profits of the transferor.

case established the broad interpretative rule that a "distribution of earnings and profits" (or a "distribution * * * chargeable to earnings and profits") meant a substantial division to the equitable owners, and not a mere "transfer intact" in the course of a change in the corporate form which lacked tax significance under Section 112. Even before the enactment of the Revenue Act of 1936, the *Sansome* case had been followed in such a number of subsequent decisions that its doctrine may fairly be said to have become an integral part of the tax law. *Murchison's Estate* v. *Commissioner*, 76 F. (2d) 641 (C. C. A. 4th); *Fain* v. *Commissioner*, 76 F. (2d) 1008 (C. C. A. 5th), certiorari denied, 296 U. S. 588; *United States* v. *Kaufman*, 62 F. (2d) 1045 (C. C. A. 9th); *Baker* v. *Commissioner*, 80 F. (2d) 813, 815 (C. C. A. 2d); *Harter* v. *Helvering*, 79 F. (2d) 12, 13 (C. C. A. 2d).

When the Revenue Act of 1936 was enacted, Congress partially embodied the doctrine of the *Sansome* case into Section 115 (h) and gave its approval to the doctrine as a whole. Section 115 (h) was added to provide that a distribution of stock or securities should not be deemed a distribution of earnings or profits of any corporation if no gain or loss to the distributee was recognized. Speaking of such tax free distributions, the Senate Finance Committee gave its approval to the principle stated in the *Sansome* case (S. Rep. 2156, 74th Cong., 2d Sess., p. 19 (1939–1 Cum. Bull. (Part 2) 678, 690)):

> In such cases, earnings or profits remain intact and hence available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. This rule is stated only in part in section 115 (h) of the Revenue Act of 1934, and corresponding provisions of prior Acts, but is the rule which is applied by the Treasury and supported by the courts in *Commissioner* v. *Sansome* (60 Fed. (2d), 931); *United States* v. *Kaufman* (62 Fed. (2d), 1045); *Murcheson* v. *Comm.* (76 Fed. (2d), 641). While making no change in the rule applied under existing law, the recommended amendment is desirable in the interest of greater clarity.

Section 115 (h), as amended applied only to the distribution of securities but there can be no doubt that its purpose was to "carve out * * * a defined group of cases to which a rule of thumb would be applied" * without narrowing the broader principle. The very considerations which led to the rule of thumb in the case of securities applied with equal force in the case of money and other property. The existing law was that there was no "distribution of earnings and profits" regardless of the medium of exchange, if the distribution resulted in no gain to the transferee because there was only a change in corporate form. And, the

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* *Helvering* v. *Clifford*, 309 U. S. 331, 337–338.

committee report cited shows plainly that Congress did not intend to change the existing law.

Turning back now to the problem before Congress in drafting Section 27 (f), it is apparent both that the phrase "distribution * * * chargeable to the earnings" was a convenient formula which would accomplish the necessary correlation with Section 112 and also that Congress was familiar with the formula. Taxpayer was right in urging in the court below that Congress intended to deny the credit for distributions chargeable to capital or to profits accumulated before 1913 and that the phrase used accomplishes those purposes. But the difficult problem was to correlate the provisions allowing the credit with the provisions of Section 112 determining whether any gain or loss should be recognized. See pp. 13–16, *supra*. Since Congress knew and approved the doctrine that for the purposes of existing Revenue Acts there was no "distribution of profits" where under Section 112 no gain or loss was recognized, Congress must have used that phrase to solve the more difficult problem as well as the simple one.

The Treasury adopted the foregoing analysis of the Revenue Act of 1936. Regulations 94 applied the doctrine of the *Sansome* case to all corporate distributions, whether of securities, and so controlled by Section 115 (h), or of money or other property, and so controlled only by the principles announced in the *Sansome* case. See Article 115–

11 (first paragraph). Article 27 (f)-1 (a) required like disregard of formal corporate changes in interpreting Section 27 (f). (See pp. 10–13, *supra*.)

In the Revenue Act of 1938 these interpretations received Congressional approval. Section 115 (h) was amended in the Revenue Act of 1938 to make the rule express:

> The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—
>
> (1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law * * *

And Section 27 (f) was reenacted without change as Section 27 (g). These provisions leave no doubt that under the 1938 Act a tax free distribution of earnings in liquidation is not a "distribution * * * chargeable to the earnings" within the meaning of Section 27 (g); for Section 115 (h) defines what is a distribution of, or properly chargeable to, earnings for the purposes of Section 27 (g) as well as for the purposes of other parts of Section 115.* The legislative history and the express

* The Board itself has recognized that in the 1936 Act Section 115 (h) limited Section 27 (f). *Reed Drug Co.* v.

retroactivity of Section 115 (h) to past transactions affecting 1938 taxes show that the amendment to Section 115 (h) did not introduce new law but was "a more explicit expression of the purpose of the prior law."[10] The Senate Committee made that entirely plain (S. Rep. No. 1567, 75th Cong., 3d Sess., pp. 18–19 (1939–1 Cum. Bull. (Part 2) 779, 792)):

Commissioner, 44 B. T. A. 573, now pending on appeal in the Circuit Court of Appeals for the Sixth Circuit.

Section 115 is by its very nature a definitive section, intended to establish principles governing the application of other provisions of the tax statute. This is made specific by the opening subdivisions which speak for the purposes of "this title" and "this Act." Section 115 (a) and (b) (Appendix, *infra*). Section 115 (h) is not said or implied to be of narrower scope.

The close relationship between Section 27 and Section 115 is readily apparent. It is clear, for instance, that when Section 27 (a) speaks of "dividends paid" it means dividends as defined in Section 115 (a), subject to such modifications as are specifically made by Section 27 itself. A distribution of capital would clearly give rise to no dividends credit because it would not be a dividend under Section 115. Section 115 (e) is specifically mentioned in Section 27 (e). The regulations promulgated under Section 27 contain numerous references to Section 115. See, *e. g.*, Regulations 94, Article 27 (f)–1 and Section 27 (h)–1. Though Section 27 (f) specifically alters the concept of Section 115 by treating some distributions in liquidation as dividends, for credit purposes, there is every reason to suppose that its expressions, such as "amounts distributed in liquidation" and "properly chargeable to the earnings or profits accumulated after February 28, 1913," were used in the same sense here as in other provisions of the Act.

For instance, if, pursuant to a plan, corporation A transferred all of its assets to corporation B for all of B's stock,

Under existing law, distributions of any property by a corporation which under the provisions of section 112 (b) or (c) are received by the shareholder without the recognition of gain to him (irrespective of what basis the property takes in the hands of such shareholder) are not regarded as being in any respect distributions of earnings or profits. Consequently, such earnings or profits remain unimpaired out of which taxable dividends may subsequently be declared either by the corporation making the distribution or by another corporation which, as to property acquired in an exchange described in section 112, takes in whole or in part the transferor's basis, so that the earnings or profits of the transferor corporation

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and then proceeded to liquidate partially by distributing half of the B stock in exchange for half of its own, there would be a tax-free reorganization and exchange under Section 112 (b) (3), 112 (b) (5), and 112 (g) (1) (C). Section 115 (c) says that the portion of a distribution in partial liquidation which is "properly chargeable to capital account" shall not be considered a distribution of earnings, and implies that the rest shall be. But it cannot be doubted that in the case supposed this provision. There was no distribution properly chargeable to earnings within the implication of Section 115 (c) because Section 115 (h) establishes that there has been no distribution of earnings of "any corporation." Likewise there was no "distribution properly chargeable to earnings" in Section 27 (f).

[10] *Jordan* v. *Roche*, 228 U. S. 436, 445; *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455, 469. Accord, *Burnet* v. *Guggenheim*, 288 U. S. 280, 283; *Higgins* v. *Smith*, 308 U. S. 473, 479–480; *White* v. *Winchester Country Club*, No. 63, this Term, decided January 12, 1942.

become in whole or in part the earnings or profits of such other corporation.

In view of the fact that sections 112 (b) (6) and (7) permit the distribution of property (including money), in addition to stock or securities, without the recognition of gain to the distributee, appropriate changes are made in section 115 (h) of the House bill in the interest of added clarity.

This development of Section 115 (h) of the 1938 Act, therefore, and the reenactment of Section 27 (f) without change after the Treasury regulations had applied uniformly through the Act the concept of a "transfer intact," are such evident congressional approval of the original regulations [11]

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[11] Cumulative evidence showing the conviction of Congress that the *Sansome* principle has long pervaded the Revenue Acts, and thus supporting Article 27 (f)-1 (a), is contained in Section 501 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, inserting subdivisions (l) and (m) in Section 115 of the Internal Revenue Code, which stated that the earnings of a corporation shall be deemed increased or decreased by gain or loss from the sale or disposition of property only to the extent that the gain or loss is recognized for tax purposes. This provision was made retroactive for all tax years, except as to cases already in litigation. It was intended to nullify the departure from the *Sansome* principle in cases like *Commissioner* v. *F. J. Young Corp.*, 103 F. (2d) 137 (C. C. A. 3d), where property was transferred from corporation A to corporation B for the latter's stock. Despite the fact that the exchange was tax free the *Young* case held that the earnings of A were increased, and consequently that a subsequent distribution by A was a distribution of those earnings. In the view of Congress this represented a misapprehension of the scheme of the Revenue Acts, as the Com-

that the courts cannot disregard their force. Cf. *Burnet* v. *Guggenheim*, 288 U. S. 280; *White* v. *Winchester Country Club*, No. 63, this Term, decided January 12, 1942; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 99; *Helvering* v. *Winmill*, 305 U. S. 79, 83; *Morgan* v. *Commissioner*, 309 U. S. 78, 81.[12]

The circuit court of appeals, however, was not persuaded by these considerations and held that Section 27 (f) should be read as an accountant would read it. The court stated that the earnings transferred from subsidiary to parent corporation would be subject to the undistributed profits tax in the hands of the latter unless it distributed them, and the court accepted the taxpayer's argument that Section 27 (f) must be given its accounting rather than its tax meaning so that it would encourage instead of deter the abolition of unnecessary corporate chains. We submit that these conclusions spring from three misconceptions.

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mittee Reports show. See H. Rep. 2894, 76th Cong., 3d Sess., pp. 41–42; S. Rep. 2114, 76th Cong., 3d Sess., p. 25. This statute approved Treasury Regulations 94 and 101, Article 115–3.

[12] The dividends credit is still important in the computation of surtax on personal holding companies and improperly accumulated corporate surplus. Internal Revenue Code, Sections 27, 102, 500–505. Cf. Revenue Act of 1938, Sections 27, 102, 401–406; Revenue Act of 1936, Sections 27, 102, 351. It was also used in 1938 and 1939 in the computation of the diminished undistributed profits surtax then in force. Revenue Act of 1938, Sections 13 and 27.

First. The court erred in stating that the earnings transferred to the parent corporation were subject in its hands to the undistributed profits tax. Its mistake was in assuming that the statute surtaxes the mere retention of earnings whereas in fact the undistributed profits surtax is levied on the accumulation and retention of earnings and not on their retention alone. In computing the tax, the starting point is "net income" (Section 14). Under Section 112 (b) (6) the transfer from taxpayer to its parent corporation did not result in gain or loss to either, hence the earnings transferred were never included in the parent's "net income" and were not subject in its hands to either the normal tax or the undistributed profits surtax.

Second. Equally ineffective is taxpayer's attempt to justify allowing current earnings to escape the surtax altogether, despite the fact that they were not taxed or surtaxed to the principal stockholder to whom they were transferred; there is not the slightest indication that Section 27 (f) was intended to induce the shortening of corporate chains by exempting from the undistributed profits tax the earnings "transferred intact" from a subsidiary to a parent corporation. It is true that Congress expressed an intention to encourage the elimination of unnecessary corporations when in 1934 it decided to retain such of the tax free reorganization provisions of Section 112 as would encourage that

result.[13] Section 112 (b) (6) is an even more specific instrument for the same purpose, the essence of which first appeared in the Revenue Act of 1935.[14] Revenue Act of 1935, c. 829, Section 110, 49 Stat. 1014. But this purpose is entirely unrelated to the undistributed profits surtax, and there is no suggestion in the 1936 Act in general, or in Section 27 (f) in particular, or in the legislative history of either, to show that Section 27 (f) was drawn as an additional instrument to accomplish that end.[15] On the contrary the arbitrary and limited scope of the inducement which is said to be held out by Section 27 (f) is proof that none was intended; under Section 115 (h) only corporations

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[13] See H. Rep. No. 704, 73d Cong., 2d Sess., pp. 12–14 (1939–1 Cum. Bull. (Part 2) 554, 563–565); S. Rep. No. 558, 73d Cong., 2d Sess., pp. 16–17 (1939–1 Cum. Bull. (Part 2) 586, 598–599).

[14] See remarks of Senator George, 80 Cong. Rec. 8799, of Senator La Follette, 80 Cong. Rec. 10469.

[15] Certainly there is no such suggestion in the following Committee Report, which is the only one specifically bearing upon Section 27 (f). House Ways and Means Subcommittee Report, March 26, 1936, 74th Cong., 2d Sess., p. 6:

> In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account.

In its brief below taxpayer made reference to Section 27 (j) of H. R. 12395, the Revenue Bill of 1936 as introduced in the House (Section 27 (i) of that bill as introduced in the Senate). The corporate tax on undistributed earnings as set up in the bill was graduated in such fashion as to afford

which liquidated by distributing property other than securities could take the advantage and by Section 115 (h) of the 1938 Act even that inducement was withdrawn.

Third. The Treasury's interpretation of Section 27 (f) does not act as a deterrent to liquidation of unnecessary subsidiary corporations, which would frustrate the purposes of Section 112 (b) (6). Taxpayer based its argument to the contrary in the court below upon a calculation showing that the total taxes paid by taxpayer and its parent corporation would have been less if taxpayer's current earnings had been distributed as ordinary dividends instead of in liquidation. But on other facts this would not be true.[16] Obviously, the statute

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a tax advantage in the formation of a lengthy chain of successive holding corporations, each of which could distribute part of its net income to the next. To discourage the establishment of such corporate chains Section 27 (j) reduced in certain circumstances the credit for dividends paid by a subsidiary corporation to its parent. Taxpayer attached significance to the elimination of Section 27 (j) from the Act as finally passed. This was wholly unwarranted. Section 27 (j) was eliminated by the Senate, as the Finance Committee explained, solely because the opportunities for evasion which it was designed to prevent were not offered by the final form of the bill. S. Rep. No. 2156, 74th Cong., 2d Sess., p. 16 (1939–1 Cum. Bull. (Part 2), 678, 688).

[16] If taxpayer had not liquidated but had declared an ordinary dividend of $1.80 per share (the amount per share of the distribution of earnings in liquidation in the instant case), and if the parent had distributed a comparatively small part of its earnings as dividends, the parent would have paid the same undistributed profits tax on taxpayer's earn-

cannot hope on any construction to achieve an exact correspondence between the amount of surtax which a corporation must pay if the earnings are retained and the amount of the normal taxes and surtaxes which the shareholders must pay if the earnings are distributed. Moreover, the argument overlooks the point that if the parent had redistributed the taxpayer's earnings to its own shareholders it could have established a dividends paid credit for taxpayer under the provisions of Article 27 (f)–1 (c) and neither corporation would have had to pay an undistributed profits tax on those earnings.

Taxpayer responds that Article 27 (f)–1 (c), allowing the subsidiary a credit for earnings declared as dividends by the parent corporation, is invalid; but in view of the substantial identity between the parent and the almost wholly owned subsidiary it is not an unreasonable construction of Section 27 to say that after the transfer of earned surplus from subsidiary to parent, its subsequent distribution by the parent is a distribution of the subsidiary's earnings. Articles 27 (f)–1 (a) and 27 (f)–1 (c), therefore, together provide a sound and reasonable scheme for the administration of Section 27 (f). The validity of the latter like the

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ings as has been charged to the taxpayer in the instant case, and in addition, would have paid a normal tax on 15 percent of those earnings, which it avoided in the instant case. Sections 14, 21; cf. Sections 13 (a) (2), 26 (b).

validity of the former must be conceded once it is recognized that the concept underlying Section 112 (b) (6) requires formal corporate changes to be ignored in applying the related provisions of the Act.[17]

3. SECTION 27 (h) SHOWS THAT FOR A NONTAXABLE DISTRIBUTION NO CREDIT IS ALLOWED

Section 27 (h), the final provision in Section 27, declares:

> (h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

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[17] The reason for the failure of Commercial Credit Company to take advantage of Article 27 (f)–1 (c) does not appear. It declared a dividend of a large part of its earnings for that year. All that it needed to do was to pass a resolution allocating a portion of that or an increased dividend to taxpayer. The regulation was promulgated November 12, 1936, giving ample opportunity. The Treasury does not seek to disavow it. It seems scarcely becoming for taxpayer to attack the regulation made for its benefit simply because it failed to take the advantage.

But even if Article 27 (f)–1 (c) were invalid, the invalidity of Article 27 (f)–1 (a) by no means follows. A corporation is not automatically exempted from the surtax merely because it has no election to avoid it by making distribution. Cf. *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46; *Crane Johnson Co.* v. *Helvering*, 311 U. S. 54.

This concluding subsection appears to be applicable to all the preceding subdivisions of Section 27. It is a general warning in keeping with the purpose of the act that no credit shall be allowed for distributions which are not ordinarily taxable to the distributee. Like Section 27 (g), therefore, it modifies the provisions stating when the dividends paid credit shall be allowed and thus both furnishes a guide to their interpretation and prohibits any credits for nontaxable distributions which they might otherwise inadvertently have permitted. *Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359 (C. C. A. 5th), certiorari denied, 309 U. S. 690; cf. *May Hosiery Mills* v. *Commissioner*, 123 F. (2d) 858 (C. C. A. 4th) (Section 27 (g)).

On its face Section 27 (h) denies the credit claimed by taxpayer regardless of the meaning of Section 27 (f). As applied to distributions in liquidation the language may be inartistic for in terms it allows a credit only if the distribution is "a taxable dividend in the hands of * * * shareholders",[19] and a distribution in liquidation is not ordinarily a dividend within the meaning of the Revenue Acts. See *Hellmich* v. *Hellman*, *supra*. The Board and court below sought to avoid the

[19] The words limiting the phrase to shareholders "subject to taxation under this title" were inserted so as not to deny the credit for distributions to charitable corporations and others exempted from the income tax by Section 101. See H. Rep. 2475, 74th Cong., 2d Sess., p. 11 (1939–1 Cum. Bull. (Part 2) 667, 674).

difficulty by holding that subsection (f) required every distribution chargeable to profits on the corporate books to be treated as a "taxable dividend" for the purposes of all the provisions of Section 27, including subsection (h). This construction however, disregards the reference to "any part" of a distribution which is not taxable "in the hands * * * of the shareholders" which appears in subsection (h) but not in subsection (f). To give force to the quoted words it is necessary to read subsection (f) as converting a distribution in liquidation out of earnings into a dividend for the ordinary purposes of Section 27, but to read subsection (h) as prohibiting the credit for those parts of dividends or distributions of any kind which are exempted from tax in the hands of the recipients. Under this construction subsection (f) authorizes the credit in the instant case for the parts of the distribution which were received by the minority stockholders, while subsection (h) denies it for the part which was distributed tax free to the parent. The propriety of reading "dividend" in subsection (h) to include a liquidating distribution is confirmed by the caption "*Nontaxable Distributions*" which stands at the head of Section 27 (h). *Maguire* v. *Commissioner*, 313 U. S. 1, 9. More important, it alone is consistent with the purposes of the undistributed profits surtax. Thus, no conflict between Section 27 (f) and Section 27 (h) is created by interpreting Sec-

tion 27 (h) as generally denying any credit for nontaxable distributions and so denying taxpayer the credit claimed, even if Section 27 (f) were to be read as an accountant would read it.

But the constructional difficulties discussed by the Board and court below can be raised only by assuming that the Treasury's construction of Section 27 (f) is wrong. If it is right, the two sections are plainly harmonious. In truth, therefore, Section 27 (h) is conclusive evidence that Section 27 (f) is to be applied to deny a credit for a mere bookkeeping distribution of earnings and to allow a credit only for a "distribution of earnings" resulting in a taxable gain or loss.

4. THE APPLICABLE TREASURY REGULATION IS A REASONABLE INTERPRETATION OF SECTION 27 (f) WHICH MUST BE GIVEN CONTROLLING EFFECT

The most that can be said for any argument in support of the decision below is that it presents a possible alternative construction of Section 27 (f). Thus, taxpayer would give the words "distribution * * * chargeable to profits" their accounting sense. For purposes of argument, we may even assume that this construction would encourage the liquidation of some unnecessary corporate chains (albeit irrationally selected; see pp. 28–29 *supra*). Notwithstanding those assumptions, there would still remain open the alternative that Congress used the words in their tax sense to exclude transfers of

corporate surpluses from one corporation in liquidation to a parent corporation owning the bulk of its stock. It can be neither denied that the phrase "distribution chargeable to earnings" has often been given that meaning in tax law nor gainsaid that to give the phrase its tax meaning in Section 27 (f) would carry out the purposes of the undistributed profits surtax and correlate in a harmonious manner the provisions of Sections 112, 115 and 27 (f). In short, taxpayer cannot show that the words were used in their accounting, and not in their tax, sense. Both the Board and court below were aware of this, but concluded that they preferred the former interpretation.

Under these circumstances, however, the Treasury interpretation expressed in Article 27 (f)–1 (a) is controlling, whatever the choice between the two interpretations might be as an original question. Article 27 (f)–1 (a) is a just and reasoned application of established principles, which gives full effect and harmony to the language of the Act. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *Spring City Co.* v. *Commissioner*, 292 U. S. 182, 189; cf. *Textile Mills Securities Corp.* v. *Commissioner*, No. 34, this Term, decided December 8, 1941. It has been approved by the reenactment of the statute. See pp. 23–26 *supra*.

Moreover, it is not without significance that Section 27 (f) is a provision allowing an exemption

from tax. This Court held in *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49:

> It is material that we are dealing here with a generally imposed surtax upon the undistributed net income of corporations, and that respondent's claim is for a credit in the nature of a specially permitted deduction. It has been said many times that provisions granting special tax exemptions are to be strictly construed. [Citing *Deputy* v. *du Pont*, 308 U. S. 488, 493; *White* v. *United States*, 305 U. S. 281, 292; *New Colonial Ice Co.* v. *Helvering*, 292 U. S. 435, 440.]

CONCLUSION

The decision of the Circuit Court of Appeals was erroneous and should be reversed.

Respectfully submitted,

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH.
HELEN R. CARLOSS,
ARTHUR A. ARMSTRONG,
Special Assistants to the Attorney General.
ARCHIBALD COX,
Attorney.

MARCH 1942.

APPENDIX

REVENUE ACT OF 1936, c. 690, 49 STAT. 1648

SEC. 13. NORMAL TAX ON CORPORATIONS.

(a) *Definition.*—As used in this title the term "normal-tax net income" means the net income minus the sum of —

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(2) *Dividends Received.*—The credit provided in section 26 (b). Such credit shall not be allowed in the case of a mutual investment company, as defined in section 48.

* * * * * * *

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26 (d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26 (e).

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

(c) *Adjusted Net Income Less Than $50,000.*—

(1) *Specified Credit.*—If the adjusted net income is less than $50,000 there shall be allowed a specific credit equal to the portion of the undistributed net income which is in excess of 10 per centum of the adjusted net

income and not in excess of $5,000, such credit to be applied as provided in paragraph (2).

(2) *Application of Specific Credit.*—If the corporation is entitled to a specific credit, the tax shall be equal to the sum of the following:

(A) A tax computed under subsection (b) upon the amount of the undistributed net income reduced by the amount of the specific credit, plus

(B) 7 per centum of the amount of the specific credit.

(d) *Exemption From Surtax.*—The following corporations shall not be subject to the surtax imposed by this section:

(1) Banks as defined in section 104.

(2) Domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States, or are insolvent and in receivership in any court of the United States or of any State, Territory, or the District of Columbia.

(3) Insurance companies subject to the tax imposed under section 201, 204, or 207.

(4) Foreign corporations.

(5) Corporations which, by reason of deriving a large portion of their gross income from sources within a possession of the United States, are entitled to the benefits of section 251.

(6) Corporations organized under the China Trade Act, 1922.

(7) Joint Stock Land Banks organized under the Federal Farm Loan Act, as amended.

(e) *Exempt Corporations.*—For corporations exempt from taxation under this title, see section 101.

(f) *Tax on Personal Holding Companies.*—For surtax on personal holding companies, see section 351.

(g) *Improper Accumulation of Surplus.*—For surtax on corporations which accumulate surplus to avoid sur tax on stockholders, see section 102.

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SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

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SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(b) *Dividends Received.*—85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this title. The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

* * * * *

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit

shall be the amount of dividends paid during the taxable year.

(b) *Dividend Carry-Over.*—In computing the dividends paid credit for any taxable year, if the dividends paid during the taxable year are less than the adjusted net income, there shall be allowed as part of the dividends paid credit, and in the following order:

(1) Dividends paid during the second preceding taxable year in excess of the adjusted net income for such year, to the extent not needed as a dividends paid credit for the taxable year preceding the taxable year the tax for which is being computed; and

(2) Dividends paid during the first preceding taxable year in excess of the adjusted net income for such year.

No credit shall be allowed for dividends paid by a corporation prior to its first taxable year under this title.

(c) *Dividends in Kind.*—If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the dividends paid credit with respect thereto shall be the adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.

(d) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value is lower than the face value,

then when the obligation is redeemed by the corporation, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

(e) *Taxable Stock Dividends.*—In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115 (f), the dividends paid credit with respect thereto shall be the fair market value of the stock or the stock right at the time of the payment.

(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

(g) *Preferential Dividends.*—No dividends paid credit shall be allowed with respect to any distribution unless the distribution is pro rata, equal in amount, and with no preference to any share of stock as compared with other shares of the same class.

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

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(b) *Exchanges Solely in Kind.*— * * *

(6) *Property received by corporation on complete liquidation of another.*—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except non-voting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the

transfer of all the property occurs within the taxable year; in such case the adoption by the stockholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and

collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

* * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(15) *Property Received by a Corporation on Complete Liquidation of Another.*—If the property was received by a corporation

upon a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor.

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3), and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liqui-

dation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

(d) *Other Distributions from Capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided

in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

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REVENUE ACT OF 1938, C. 289, 52 STAT. 447

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

* * * * *

TREASURY REGULATIONS 94, PROMULGATED UNDER REVENUE ACT OF 1936

ART. 27 (f)-1. *Dividends paid credit for distributions in liquidation.*—(a) *Distributions which diminish earnings or profits.*—To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27 (f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Act as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if—

(1) Under the provisions of section 115 (c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, a dividends paid credit is allowable for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of

such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.*—In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or

profits accumulated since February 28, 1913. The application of this paragraph may be illustrated by the following example:

Example: The Y Corporation was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $7 per share and $100 per share on complete liquidation of the corporation in priority to any payments on common stock, and was to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. In 1910 the preferred stock was issued at $106 per share, for a total of $106,000, and the common stock was issued, at $100 per share, for a total of $200,000. On July 15, 1936, the company had a paid-in surplus of $6,000, consisting of the premium received on the preferred stock, earnings or profits of $30,000 accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1936, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $141,000 in a transaction upon which gain or loss to the distributees resulting from the exchange was determined and recognized under the Act, such transaction being only a par-

tial liquidation under section 115 (c). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to par value, $6,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated prior to March 1, 1913). The remainder, $25,000 ($141,000, the amount of the distribution, less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is allowable as a dividends paid credit.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.*—If, as a result of one or more transactions described in Section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of the transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the purposes of the dividends paid credit, any such distribution so allocated shall be treated as a dividend paid only in the computation of the credit allowable to the transferor, and must be consistently so treated by both corporations for the cur-

rent and succeeding taxable years. Each corporation shall file as a part of its return for the taxable year involved, (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No dividends paid credit based upon such apportionment and allocation will be allowed unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph. The provisions of this paragraph may be illustrated by the following example:

Example: The P Corporation, which keeps its books and makes its income tax returns on the basis of a fiscal year ending March 31, owned all of the capital stock of the S Corporation. The S Corporation, which keeps its books and makes its returns on the calendar year basis, was completely liquidated on December 1, 1936. At that time, the S Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $50,000, in addition to earnings or profits for 1936 of $20,000, and an adjusted net income of $45,000. It had paid no dividends prior

to its liquidation. The P Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $60,000 in addition to earnings or profits of the taxable year computed as of the end of the year in the amount of $80,000, and an adjusted net income in the amount of $60,000. The P Corporation pays dividends as follows: June 15, 1936, $25,000; September 15, 1936, $25,000; December 15, 1936, $25,000; and March 15, 1937, $25,000. No portion of the dividends paid on June 15 and September 15 prior to the liquidation and no portion of the dividend paid on March 15, 1937, after the close of the taxable year of the S Corporation may be allocated to the S Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one effecting a distribution out of the current earnings or profits of the S Corporation to the extent of $20,000. No part of that distribution may be allocated to the S Corporation's accumulated earnings or profits since, under section 115 (b), the earnings or profits of the P Corporation and the S Corporation for the taxable year ($100,000) are sufficient in amount to cover all the distributions made during that year ($100,000).

* * * * * *

ART. 27 (h)-1. *Nontaxable distributions.*—No dividends paid credit shall be allowed with respect to any part of the distribution by a corporation to its shareholders which is—

(a) not out of earnings or profits of the taxable year or out of earnings or profits of the corporation accumulated subsequent to February 28, 1913 (see section 115), or, in the case of distributions in

liquidation, not properly chargeable to earnings or profits of the corporation accumulated after February 28, 1913, under article 27 (f)–1;

(b) in the case of a corporation which was classified as a personal service corporation under the Revenue Act of 1918 or the Revenue Act of 1921, out of earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921 (see section 115 (e)); or

(c) a distribution in stock of the corporation or rights to acquire its stock which does not constitute income to its shareholders within the meaning of the sixteenth amendment to the Constitution (see section 115 (f) and articles 115–3 and 115–4).

The effect of subsections (g) and (h) of section 27 is that no dividends paid credit is allowed with respect to any distribution unless each of the shareholders of that class, who are subject to taxation under Title I for the period in which the distribution is made, receives a taxable dividend as a result of the distribution.

The application of section 27 (h) may be illustrated by the following examples:

Example (1): A, B, C, and D are the shareholders of the Y Corporation, which makes its returns on the calendar year basis, D being an educational corporation exempt from income tax under section 101. On July 15, 1936, the Y Corporation paid a dividend (within the meaning of section 115) in cash of $1,000. A and B make their returns on the calendar year basis, but C makes his return on the basis of the fiscal year ending July 31. The

Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

Example (2): If the facts in the preceding example are the same, except that A and B make their returns on the basis of the fiscal year ending July 31, the Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

* * * * *

ART. 115–11. *Effect on earnings or profits on certain tax-free exchanges and tax-free distributions.*—If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and intercompany transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.

The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

(1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization—

(A) in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or

(B) in any taxable year (beginning before January 1, 1936, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3)) if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraphs (1) and (2) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange.

For the purposes of this article, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932, and for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934.

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No. 708.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CREDIT ALLIANCE CORPORATION.

MEMORANDUM OF RESPONDENT.

NEWELL W. ELLISON,
DUANE R. DILLS,
JACK J. LEVINSON,
CHRISTOPHER S. SARGENT,
Attorneys for Respondent.

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MEMORANDUM OF RESPONDENT.

In view of the conflict between the Circuit Courts of Appeals on the question whether Section 27 (f) of the Revenue Act of 1936 is modified by Section 27 (h) of that Act[1], Respondent does not oppose the grant of certiorari in this case.

The Government urges as a second reason for the granting of the petition that the Court below, in holding the dis-

[1] The Government prevailed, one judge dissenting, in *Centennial Oil Co.* v. *Thomas, Collector of Internal Revenue*, 109 F. (2d) 359 (C. C. A. 5). Since that time, the Court below decided the instant case against the Government, as did the Court in *Commissioner of Internal Revenue* v. *Kay Manufacturing Corp.*, 122 F. (2d) 443 (C. C. A. 2).

tribution in this case to be "properly chargeable to the earnings or profits" of the Respondent within the meaning of Section 27 (f), appears to have established a principle inconsistent with the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Sansome*[2] and possibly in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Centennial Oil Co.* v. *Thomas*[3]. Respondent points out in complete answer that the decision in the *Sansome* case was by the same Court that later decided the *Kay Manufacturing Corp.* case[4] in favor of the taxpayer. Furthermore, the Court, in the *Centennial Oil Co.* case, did not discuss or refer to the question whether the distribution was "properly chargeable to the earnings or profits". If this were the only reason assigned by the Government for the grant of the petition, its petition should be denied because this argument of the Government was properly rejected by the Court below and the Court in the *Kay Manufacturing Corp.* case and has never been approved by any court.

Respectfully submitted,

NEWELL W. ELLISON,
DUANE R. DILLS,
JACK J. LEVINSON,
CHRISTOPHER S. SARGENT,
Attorneys for Respondent.

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[2] *Commissioner of Internal Revenue* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2), certiorari denied, 287 U. S. 667.

[3] 109 F. (2d) 359 (C. C. A. 5).

[4] *Commissioner of Internal Revenue* v. *Kay Manufacturing Corp.*, 122 F. (2d) 443 (C. C. A. 2). This case and the instant case involve exactly the same questions and the Government has filed a petition for certiorari contemporaneously with the filing of the petition in the instant case.

No. 708

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

CREDIT ALLIANCE CORPORATION

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit

BRIEF FOR THE RESPONDENT

NEWELL W. ELLISON,
DUANE R. DILLS,
JACK J. LEVINSON,
CHRISTOPHER S. SARGENT,
Attorneys for Respondent.

MARION P. WORMHOUDT,
Of Counsel.

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v.

CREDIT ALLIANCE CORPORATION

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 13-24) is reported at 42 B. T. A. 1020. The opinion of the Circuit Court of Appeals (R. 32-38) is reported at 122 F. (2d) 361.

JURISDICTION

The jurisdiction of this Court has been invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Is a dividends paid credit allowable under Section 27 (f) of the Revenue Act of 1936 for earnings and profits distributed to a parent corporation in complete liquidation under Section 112 (b) (6) of that Act which provides that no gain or loss shall be recognized on receipt of the distribution?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in Appendix A, *infra*, pp. 38-52.

STATEMENT

The facts as stipulated (R. 10-13) were found by the Board of Tax Appeals (R. 14) and may be summarized[1] as follows:

Respondent, Credit Alliance Corporation, was organized in 1922, under the laws of New York, and dissolved in July of 1937 (R. 10). During its corporate existence respondent was actively engaged in business. In 1930 the Commercial Credit Company, a Delaware corporation, acquired more than 80 per cent of respondent's outstanding capital stock and by December 1, 1936, it owned 526,238 shares out of 528,186 shares outstanding (99.63 per cent) (R. 11). Its holding continued the same until cancellation of all stock, which took place beginning in 1936. In that year liquidation of respondent was decided upon, in order to simplify the corporate structure, and on December 1, 1936, the stock-

[1] We summarize the facts as stipulated because the Commissioner has used the "Statement" to argue his case. See Commissioner's Brief, pp. 3, 4, 5.

holders and directors of respondent, by appropriate action, resolved to liquidate the corporation completely within three years, to distribute in liquidation property equivalent to $1.80 per share, to reduce the stated value of stock from $8.00 to $1.00 per share on December 10, 1936, by a reduction of capital and to distribute $7.00 per share in liquidation on that date to the stockholders of record as of December 3, 1936 (R. 11).

In accordance with the plan of complete liquidation, respondent distributed in 1936, out of earnings and profits, cash and property of a stipulated value of $950,734.80 (R. 11). Respondent's parent, Commercial Credit Company, received $947,228.40 and respondent's remaining shareholders received $3,506.40. In 1936 respondent also distributed to its stockholders $3,697,202.00 by reduction of capital as aforementioned. Further distributions were made in 1937 and the liquidation was completed in 1938. Pursuant to Section 112 (b) (6) of the Revenue Act of 1936 no gain or loss was recognized to Commercial Credit on this liquidation (R. 12).

Admittedly (R. 11), the $950,734.80 was in fact distributed in liquidation out of "earnings and profits accumulated after February 28, 1913" and in its income tax return for 1936 respondent claimed a dividends paid credit under Sections 14 and 27 of the Revenue Act of 1936 for the full amount of that liquidation distribution (R. 41). The Commissioner, petitioner here, allowed the credit to the extent of the amount distributed to minority stockholders, but disallowed it to the extent of $947,228.40, the amount distributed to the parent company. This resulted in the determination of a deficiency of $121,814.49 in respondent's undistributed profits tax for 1936 (R. 5).

Respondent filed a petition for redetermination (R. 2) and the Board of Tax Appeals (after consideration by the full Board) held that there was no deficiency (R. 13). The Commissioner filed a petition for review, and the Circuit Court of Appeals for the Fourth Circuit, in a unanimous decision, affirmed the decision of the Board of Tax Appeals (R. 32). Shortly thereafter, the Circuit Court of Appeals for the Second Circuit, again unanimously, reached the same decision on the same question in another case. *Commissioner* v. *Kay Manufacturing Corp.*, 122 F. (2d) 443.

The Commissioner sought certiorari, claiming a conflict between the decision below and *Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359 (C. C. A. 5), certiorari denied 309 U. S. 690. Respondent did not oppose the Commissioner's petition because admittedly there was a conflict between the decision by the Fifth Circuit and the decisions by the Second and Fourth Circuits on the question whether Section 27 (h) denied the credit allowed by Section 27 (f).

ARGUMENT

Setting of the Case

In this case the Commissioner claims an "undistributed profits surtax" is owing upon the 1936 earnings of Credit Alliance, even though it is admitted as a fact that Credit Alliance, in 1936, distributed to its stockholders in complete liquidation, in addition to capital, earnings accumulated since February 28, 1913 in an amount in excess of its adjusted net income for 1936.

This case is concerned with only one of the tax consequences of the distribution of earnings by a subsidiary (Credit Alliance) to its parent (Commercial Credit)

in a complete liquidation. There is no dispute here as to the effect of the distribution on the parent, since by reason of Section 112 (b) (6) of the Revenue Act of 1936 no gain or loss was recognized to the parent as a result of the liquidation of the subsidiary. Nor is there any dispute here as to the liability of respondent or its parent for ordinary income taxes which each paid in very substantial amounts for the year 1936. The only issue here is whether Credit Alliance should have paid an undistributed profits surtax for 1936 even though its earnings were in fact distributed during that year.

The undistributed profits surtax appeared for the first time in the Revenue Act of 1936.[2] Section 14 (b) of that Act imposes a surtax at graduated rates upon the undistributed profits of corporations. The tax is computed upon such portions of "undistributed net income" as are in excess of specified percentages of "adjusted net income".

The term "adjusted net income" is defined as net income less normal income tax and certain specified credits. The term "undistributed net income" is defined as "the adjusted net income minus the sum of the dividends paid credit provided in Section 27", and another credit which is of no importance in this case.

Whether Credit Alliance should have paid an undistributed profits surtax, as the Commissioner is claiming, depends upon whether it was entitled to a "dividends paid credit" under Section 27 of the 1936 Act because it distributed its earnings and profits in liquidation. That is the narrow question in this case.

---

[2] The surtax because of undistributed profits disappeared completely in the Revenue Act of 1938. Undistributed profits were considered only for the purpose of determining whether a small credit, in no event to exceed 2½%, should be allowed against the ordinary income tax.

If the "dividends paid credit" of Credit Alliance equals or exceeds its "adjusted net income", Credit Alliance is not liable for an undistributed profits tax. Section 27 (f) of the 1936 Act grants a "dividends paid credit" where (a) there are "amounts distributed in liquidation" and (b) the amounts are "properly chargeable to the earnings or profits accumulated after February 28, 1913". The Section specifically provides that distributions possessing these two characteristics shall "for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid".

It is admitted that in fact Credit Alliance distributed the amount of $950,734.80 in liquidation and it is further admitted that this amount was distributed out of earnings and profits accumulated since February 28, 1913, and it is also admitted that the adjusted net income of Credit Alliance for the year 1936 was less than $950,734.80 (R. 7, 11). Notwithstanding these undisputed facts, the Commissioner contends that Credit Alliance is not entitled to a dividends paid credit in the amount of $950,734.80 because he says that even though Section 27 (f) provides that a liquidation distribution shall "be treated as a taxable dividend paid", it cannot be treated as a taxable dividend paid unless it is in fact taxable in the hands of the recipient.

I

Section 27 (f) Requires the Allowance of the Credit

If the language of Section 27 of the Revenue Act of 1936 is given its plain and ordinary meaning, Credit Alliance is entitled to a dividends paid credit in the sum of $950,734.80 and is therefore not liable for an

undistributed profits surtax for the year 1936. Recognition of the plain and ordinary meaning of the language gives to each of the subsections of Section 27 a rational meaning and function and, as it will appear, is thoroughly consistent with the purpose of the undistributed profits tax law.

In support of our argument, we shall first examine the pertinent sections of the law—with particular emphasis upon Section 27 (f), which deals with distributions in liquidation—and we shall then show that the $950,734.80 distribution complies with each and every requirement necessary to qualify it as a dividends paid credit.

A. Pertinent Subsections of Section 27

Section 27 (a)[3] of the Revenue Act of 1936 defines the dividends paid credit as "the amount of dividends paid during the taxable year". Section 27 (f) is the only subsection of Section 27 specifically referring to a distribution in liquidation. It provides:

> "*Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

Section 27 (h), upon which the Commissioner once greatly relied and still does somewhat rely, provides:

[3] Section 27 (b), (c), (d), (e) and (g) need not be considered here since they are concerned, respectively, with dividend carryovers, dividends in kind, dividends in obligations of the corporation, taxable stock dividends, and preferential dividends.

> "*Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

To determine whether respondent is entitled to the dividends paid credit herein questioned, we must examine first the meaning of Section 27 (f) and then determine whether this distribution in liquidation is within the meaning of that Section. Once we establish that this distribution comes within the plain meaning of Section 27 (f), all the complicated arguments of the Commissioner, based upon other sections of the Act, must give way, as must his regulations.

B. Significance of the Language of Section 27 (f)

In the absence of a further statutory provision, a distribution in liquidation would not have qualified as a "dividend paid" within the meaning of Section 27 (a). *Hellmich* v. *Hellman*, 276 U. S. 233. In order, therefore, for a distribution in liquidation to qualify as a dividends paid credit, it was necessary for Congress to make specific provision for it in the Act. This was done in Section 27 (f).

The vital part of Section 27 (f), therefore, in so far as it concerns us here[4] is that

> "* * * amounts distributed in liquidation * * * shall, for the purposes of computing the dividends

[4] For the present we shall assume that the distribution in question is "properly chargeable to the earnings or profits accumulated after February 28, 1913". This question will be taken up separately (p. 11, *infra*).

paid credit under this section, *be treated as a taxable dividend paid*". (Italics supplied)

Similarly, Section 27 (h) provides:

"If any part of a distribution * * * is not a taxable dividend * * * no dividends paid credit shall be allowed with respect to such part".

Section 27 (f) thus provides that a liquidating distribution is to be treated not only as a dividend paid, but also as a *taxable* dividend paid, in computing the dividends paid credit to which the distributor is entitled. Thus, Congress, by Section 27 (f), required that a distribution in liquidation be *treated*: (1) as a "dividend" to overcome the difficulties in the *Hellmich* case; (2) as a "dividend paid" in order to qualify under Section 27 (a); and (3) as a "taxable dividend paid" to meet any requirements imposed by Section 27 (h). In direct and positive language, Congress said that a distribution in liquidation of earnings shall "be treated as", that is, shall be considered a "taxable dividend paid" irrespective of whether it *actually* be such or not.

The requirement of Section 27 (f) that amounts to be treated as a taxable dividend paid must be in fact "distributed in liquidation" is met by the stipulation of the parties that Credit Alliance "distributed to its stockholders, out of earned surplus cash and property of the value of $950,734.80". In law, the word "distributed" as used in the stipulation and as used in Section 27 (f) must mean what it has always meant in the Revenue Acts, namely, a transfer of something. For example, the transfer of the property by Credit Alliance in the instant case was a "distribution" within the meaning of Section 112 (b) (6) of the Revenue

Act of 1936. Certainly Congress should not be considered as having used the word "distributed" as meaning one thing in Section 27 (f) and something quite different in other sections of the same Revenue Act.

By making this distribution in liquidation a taxable dividend paid "for the purposes of computing the dividends paid credit under this section", it is stated in as blunt and simple language as is possible that every other subsection of Section 27 must be read in the light of the governing Section 27 (f).

Section 27 (f) qualifies the distribution as a "taxable dividend paid" under Section 27 (a). The requirement of Section 27 (h) that the dividend be taxable to the recipient, if applicable, is likewise completely met. Under Section 27 (f) the distribution must be "treated as a *taxable* dividend paid." We emphasize the word "*taxable*" which the Commissioner has continuously attempted to disregard. The Board of Tax Appeals and the Circuit Court of Appeals for the Fourth Circuit, as well as for the Second Circuit, have all recognized that Congress would not have provided in Section 27 (f) that a distribution should be *treated* as a "taxable dividend paid" and mean by such language that a distribution so treated would not meet the requirement of being a taxable dividend paid. As the Court said in the *Kay Manufacturing* case, *supra*, to do so would have deprived Section 27 (f) of all utility.

The whole argument of the Commissioner in this case is an attempt to delete the word "taxable" from the statute. Specifically, he attempts, by regulation, to deny the dividends paid credit upon the assumption that he has the power to erase from Section 27 (f) the word "taxable". If the Commissioner had such power, we would not be here. He disregards the unequivocal

command of Section 27 (f) that precisely this kind of distribution must be "treated" as if it were taxable, and taxable in the hands of the recipient since it could not be taxable anywhere else. No matter how tortuous his argument, the Commissioner cannot escape the demand of Section 27 (f) that this distribution be treated as "taxable" for all "purposes of computing the dividends paid credit".

We return now to the only remaining requirement of Section 27 (f), namely, that the distribution be "properly chargeable" to the earnings or profits accumulated after February 28, 1913. We submit that this statutory language must also be given its plain meaning, as was done by the Board and the Circuit Court of Appeals in this case, and by the Second Circuit in the *Kay Manufacturing* case.[5] As the Board and these Courts held, this language means, as it has always meant in the tax laws, that a distribution is properly chargeable to earnings or profits when it consists of earnings or profits and not of capital. Hence, our inquiry is whether in fact the $950,734.80 was distributed out of earnings or out of capital.

Inquiry ends in the stipulation, which states that out of a total distribution by Credit Alliance of $4,648,030.80, part ($3,697,302.00) was a distribution of capital and the remainder ($950,734.80) was a distribution of "cash and property" which was "distributed * * * out of earned surplus" which "represented, in its entirety, earnings and profits accumulated since February 28, 1913" (R. 11-12). In other words, the distribution

[5] Not only have these Courts rejected the Commissioner's interpretation of "properly chargeable", but no Court has ever accepted it. The Fifth Circuit in the *Centennial Oil* case decided for the Commissioner on the different ground that Section 27 (h) denied the credit.

of $950,734.80 was not out of capital but was chargeable solely to earnings or profits. Result: A dividends paid credit as claimed by this respondent.

That the words "properly chargeable to" were used by Congress in their normal and usual tax meaning, as we contend, is established by the Report of the Subcommittee of the Committee on Ways and Means on this very Section (74th Cong., 2nd Sess., March 26, 1936, p. 6) which said:

> "In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account".

We do not see how the Commissioner can escape from the fact that Congress specifically set up as the test of chargeability the determination whether in fact the distribution came from earnings or from capital. If from the former, Congress intended that the dividends paid credit should be given; if from the latter, Congress intended that it should be denied. In this case the $950,734.80 was stipulated to be the former—thus determining the exact dividends paid credit to which this respondent is entitled.

Had the stock of Credit Alliance been owned entirely by individuals or had it been possible to liquidate the company in such manner as to avoid the application of Section 112 (b)(6), there is no doubt but that the Commissioner would have agreed that the stipulated figure as to earnings and profits distributed constituted "the part of such distribution which is *properly chargeable* to the earnings or profits accumulated after February

28, 1913". He would then obviously have taken the stipulated figure and allowed the dividends paid credit to that extent. And, yet, there is nothing in the Revenue Act of 1936 which indicates that the words "properly chargeable to" take on a different and varying meaning dependent on the taxable or non-taxable status of the recipient stockholders.

The reason why Congress inserted the words "properly chargeable to earnings and profits accumulated after February 28, 1913" in Section 27 (f) is readily apparent. "Dividends" alone, or contracts restricting their payment, were the only escape from the surtax on undistributed profits. Section 115 (a) provides that "dividends" are payable only out of "earnings or profits". Therefore, a distribution could only constitute a "dividend" to the extent there are "earnings and profits". This was particularly important in the case of liquidation distributions which ordinarily would involve substantial distributions of capital. To the extent of capital distributions Congress did not intend to permit a dividends paid credit. The proper charging of distributions to earnings or to capital was also of particular importance in the case of liquidations occurring over a period of more than one year since then it was necessary to ascertain the amount of earnings or profits available for distribution, or distributed, in subsequent years.

The words "properly chargeable to" are by no means new to the Revenue Act and they have been used in the past in comparable liquidation provisions to mean what they mean in Section 27 (f). We use the words, and rely upon them, to mean precisely what Congress has time and again said that they mean in the taxing statutes, while the Commissioner must rely

upon his own novel and unapproved interpretation of their meaning.

When the words "properly chargeable" first came into the revenue laws, Congress used them to distinguish a distribution of capital from a distribution of earnings. For example, in the partial liquidation provision of Section 201 (c) of the Revenue Act of 1924, it is stated that the part of an amount distributed in liquidation "which is properly chargeable to capital account" shall not be considered a distribution of earnings for the purpose of determining the taxability of subsequent distributions by the corporation.

The reports on Section 201 (c) of the Revenue Act of 1924, of both the House Ways and Means Committee (68th Cong., 1st Sess. H. Rept. 179, pp. 11-12) and the Senate Finance Committee (68th Cong., 1st Sess. S. Rept. 398, pp. 11-12) state as follows:

> "It is provided in the last sentence of section 201 (c) of the proposed bill that amounts distributed in partial liquidation of a corporation shall not, to the extent that they are properly chargeable to capital account, be treated as distributions of earnings and profits for the purpose of determining the taxability of subsequent distributions by the corporation. No similar provision is contained in the existing law, although the provisions of the bill represent what is probably the correct construction of the existing law and unquestionably what is in accord with business practice."

Section 115 (c), Revenue Act of 1936, covering distributions in liquidation, contains substantially the same language as Section 201 (c), Revenue Act of 1924, namely, that "the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits".

The words "properly chargeable to" as used in Section 201 (c), Revenue Act of 1924, and similar provisions of subsequent Revenue Acts, including Section 27 (f) of the 1936 Act, clearly require a division of the distributions into earnings and capital—not some intricate theory which would make the amounts "properly chargeable to" dependent upon whether the distribution was in whole or in part tax free to the stockholders.

Once it is shown that the distribution is out of earnings or profits and not out of capital, it is properly chargeable to earnings, and the mandate of Section 27 (f) is that then the distribution shall be *treated as taxable*. The Commissioner, on the other hand, insists that notwithstanding the fact that the distribution is from earnings as distinguished from capital, it cannot be properly chargeable to earnings unless the distribution is taxable to the recipient. By this illogical reasoning, he eliminates completely the necessity for the word "taxable" in Section 27 (f). It should be obvious from the language of the subsection that the requirement of "properly chargeable" produces the effect of the distribution being "treated as taxable", and that actual taxability of the distribution is not a prerequisite of making it "properly chargeable". The Commissioner's construction flies squarely in the face of the cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word of a statute. *Market Co.* v. *Hoffman*, 101 U. S. 112, 115; *United States* v. *Standard Brewery, Inc.*, 251 U. S. 210, 218.

The Board of Tax Appeals, in considering the meaning of the term "properly chargeable" in this case, held that the phrase must be given its usual significance to indicate that which is distributed out of earnings as

contra-distinguished from that which is distributed out of capital. For example, in Section 115 (g) of the Revenue Act of 1936 the phrase "represents a distribution of earnings or profits accumulated after February 28, 1913" appears. That subsection deals with distributions in redemption of stock, and there can be no question, as the Board pointed out, that a distinction between capital and profits was intended. Again, in Section 113 (b) (1), dealing with the adjusted basis for the determination of gain or loss, it is provided that adjustments shall be made "for expenditures, receipts, losses, or other items, properly chargeable to capital account". The term "properly chargeable to capital account", as in all other cases, was used to distinguish from items *properly chargeable* to income or earnings.

The construction and meaning placed upon the term by respondent is also squarely supported by the Circuit Court of Appeals, Second Circuit, in the case of *Commissioner v. Kay Manufacturing Corp.*,[6] where the Court, in construing Section 27 (f) of the Revenue Act of 1936, said:

> "When it speaks of part of such distribution as being 'properly chargeable' to accumulated earnings, we agree with the Board that the term was used in its ordinary meaning to distinguish between capital and earnings and without reference to whether the earnings would be taxable in the hands of the distributee."

We rely on the plain and usual tax meaning of the statutory words and submit that it is entirely unnecessary to impute to those words an extraordinary and hidden meaning as contended for by the Commissioner. The language of Section 27 (f) is plain and the Con-

[6] 122 F. (2d) 443, 445.

gressional intent is clear. It squarely covers $950,734.80 of the $4,648,036.80 distribution made by Credit Alliance to its stockholders on December 10, 1936.

II

The Commissioner's Argument and Regulations Find No Support in the 1936 Act.

We have gone to some length to point out that the credit in this case is specifically authorized and required by Section 27 (f). As the question has been argued in several lower courts, the Commissioner has attempted to avoid the command of Section 27 (f) on first one ground and then another.[7] Always, the Commis-

[7] The Commissioner argued before the first appellate court to pass upon the precise problem here, that Section 27 (h) is an exception to, and controls, Section 27 (f). A majority of the Circuit Court of Appeals for the Fifth Circuit so held. (*Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359). Judge Hutcheson dissented in an exhaustive opinion pointing out that the plain language of 27 (f) requires the allowance of the credit and Section 27 (h) does not take it away. He did not think that the Commissioner had any authority to amend the Revenue Act by a regulation denying the credit Congress has allowed.

When the instant case came before the Board of Tax Appeals, the Commissioner relied heavily upon the theory which had prevailed before the Fifth Circuit, but the Board held that 27 (f), and not 27 (h), controlled. The Commissioner also argued that the distribution was not properly chargeable to earnings and profits because Section 115 (h) of the 1938 Act provided that a distribution in liquidation of securities or property other than securities, including money, to a parent was not a distribution of earnings. The Board rejected the notion that the 1938 Act could have any bearing in this case.

On appeal to the Fourth Circuit, the Commissioner largely abandoned his reliance on Section 27 (h) and stressed the contention that there was no distribution properly chargeable to earnings. The Commissioner's complicated and "tortuous" argument was rejected by the court. Shortly thereafter, the same question was determined against the Commissioner by the Circuit Court of Appeals for the Second Circuit in *Commissioner of Internal Revenue* v. *Kay Mfg. Corp.*, 122 F. (2d)

sioner's argument has involved the striking out from Section 27 (f) of the word "taxable" so that under any one of the Commissioner's different arguments Section 27 (f) has been, to use the words of the Second Circuit, deprived of its "utility".[8]

The Commissioner now takes the position before this Court that the plain words of Section 27 (f) cannot be given effect here because the Commissioner dictated differently in his Regulations. We will admit that if the Commissioner can delete what Congress has legislated, then the Regulations, and not the statute, must control this case. However, since the Commissioner has no such power, we will consider, as we turn to his contentions, his claim that the Regulation finds support either in Section 115 (h) of the 1936 Act or Section 27 (h) of that Act. We will then have reached the nub of the Commissioner's case, namely, that the Regulation should in any event control.

A. Neither Section 115 (h) nor Section 27 (h) Takes Away the Credit Allowed by Section 27 (f).

1. Section 115 (h) has no bearing here. Despite the plain language of 27 (f), the Commissioner argues that the words "properly chargeable" have a hidden and complicated meaning. It is not surprising that the Commissioner advances a complicated argument in an attempt to justify his complicated interpretation of the statute. We understand his argument to be the following:

> (a) A transfer in a tax-free reorganization under Section 112 has been held not to diminish the earnings and profits transferred, nor to render them a part of the transferee's capital account. Instead, the earnings and profits of the distributor remain earnings and profits in the hands of the dis-

[8] 122 F. (2d), at 445.

tributee, available for distribution as dividends which are taxable as income upon receipt by the distributee's stockholders. *Commissioner* v. *Sansome*.[9]

(b) Section 115 (h) of the Revenue Act of 1936 adopted the *Sansome* rule in the case of a distribution of securities but the principle is alike applicable to distributions of money and property, even though Section 115 (h) spoke only of stock or securities.

(c) Proof that Congress meant to include money and property in Section 115 (h) of the 1936 Revenue Act is shown by the fact that Congress amended Section 115 (h) in the 1938 Act specifically to include money in addition to stock and securities. The Committee Reports accompanying the 1936 and 1938 Acts, so the Commissioner says, show that Congress was only applying the general *Sansome* rule.

Each time the Commissioner has put this three-step argument to a court, the argument has been wholly rejected. The reasons are not difficult to find, and we will attempt to state them briefly.

(a) The *Sansome* case stands for the principle that earnings and profits of a predecessor corporation on a tax-free reorganization remained earnings and profits of the successor corporation after the reorganization. Of course, the *Sansome* situation is different from the situation here. In the *Sansome* case the transfer of the assets to the new company would have resulted in a gain to the *transferor* company except for the reorganization provisions of the Revenue Act. Gain or loss to the transferor on the transfer was accordingly postponed. On the other hand, the instant case involved a mere distribution of assets in kind in liquidation and could never have resulted in gain or loss to

[9] *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2) and other cases cited by the Commissioner in his brief at p. 19.

the transferor, Credit Alliance. The Commissioner's Regulations have always so held.[10] Furthermore, in the *Sansome* case, the stockholders of the old company retained an interest in its earnings and profits through stock which they received in the new company. In the instant case, we do not have a reorganization, but have instead a complete liquidation. Accordingly, the assets in which the earnings and profits of respondent were invested were distributed directly to the stockholders, including the parent company, in liquidation of the stock which it held in respondent. The Commissioner's brief (fn. 11, p. 25) refers to Section 501, Revenue Act of 1940, as indicating the conviction of Congress that the *Sansome* principle has long pervaded the Revenue Acts. But the Senate Committee Report on this Section (Report No. 2114, 76th Cong., 3rd Sess., p. 25) is a strong indication that Congress never considered the rule applicable unless gain or loss of the transferor was postponed. The report states in part as follows:

> "Under various provisions of the Internal Revenue Code dealing with exchanges and liquidations, the transfer of the property by a corporation to another corporation results in the nonrecognition, in whole or in part, of the gain or loss *realized by the transferor* upon such transfer. In such cases well established principles of income tax law require that the earnings and profits of the transferor shall go over to the transferee and shall be considered to be earnings and profits of the transferee for tax purposes. These principles are to be given full effect under Section 501." (Italics supplied)

Since Credit Alliance could not *realize* any gain or loss upon its liquidation and it was therefore unnecessary

[10] Article 22(a)-21 of Regulations 94 and similar provisions of prior regulations.

to rely upon the "non recognition" provisions of the Internal Revenue Code, it follows that the instant case is not one of "such cases" covered by the *Sansome* case and the "well established principles of income tax law".

Furthermore, we do not need to consider here the possible application of the *Sansome* case to future dividends declared by Commercial Credit. It makes no difference whatsoever when we consider the position of the distributor for purposes of the undistributed profits tax, whether profits remain intact in the hands of the distributee or have become capital account in its hands. We are dealing here with a tax imposed upon the distributor and we are unconcerned with the question decided in the *Sansome* case of the tax to be imposed upon a shareholder of the distributee.

The *Sansome* case was decided by the Second Circuit as was the *Kay* case. That Court exploded the fallacy of the Commissioner's argument that its own earlier *Sansome* decision had any application. The Court said:

> "Section 27 (f) deals with liquidation distributions from the standpoint of the liquidating corporation rather than the distributee."[11]

The Commissioner says that necessarily the *Sansome* case must have "also decided" that the liquidation did not result in a distribution of earnings, for otherwise those earnings would not have remained intact. (Commissioner's brief, pp. 17-18) No authority is cited for this extraordinary assumption and to us it seems to be a complete *non sequitur*. The Court did not decide whether there was a distribution or not; it did not find itself facing any such problem. The Court in that

[11] *Commissioner of Internal Revenue* v. *Kay Mfg. Corp.*, 122 F. (2d) 443, at 445 (C. C. A. 2, 1941).

case was looking at the situation from the standpoint of the distributee. It held that there had been a transfer, but that the assets did not change from earnings into capital by virtue of the reorganization.

(b) The second step of the Commissioner's argument is that Congress partially embodied the doctrine of the *Sansome* case into Section 115 (h) of the 1936 Act, but meant to give its approval to the *Sansome* doctrine as a whole. (Commissioner's brief, p. 19) Section 115 (h) of the 1936 Act provided that a distribution of "stock or securities" is not a "distribution" of earnings or profits if no gain to the distributee is recognized on the distribution. Section 115 (h) has no conceivable bearing here because the distribution in the instant case was of money and property and was not of "stock and securities". That was stipulated (R. 3).

The Commissioner says that this Section is applicable because it shows a Congressional acceptance of the doctrine of the *Sansome* case. For the reasons we have already stated, the *Sansome* decision has no bearing on this case, and so it is immaterial that the irrelevant Section 115 (h) is declaratory of the irrelevant *Sansome* doctrine. The Senate Finance Committee Report,[12] which relates to Section 115 (h) of the 1936 Act, says specifically that the result of the *Sansome* doctrine is that stockholders of the distributee must pay a tax when the earnings of the distributor are distributed by the distributee. Nothing in that Committee Report (which is only partially quoted in the Commissioner's brief at p. 20) supports a theory that either the *Sansome* case or Section 115 (h) has any application to the tax status of a distributor of money and property other than securities.

[12] S. Rept. 2156, 74th Cong., 2nd Sess., *Seidman, Legislative History of Federal Income Tax Laws*, p. 251.

Even if Section 115 (h) of the 1936 Act could be viewed as affecting a distributor in a *Sansome* situation, that very fact would destroy the Commissioner's argument in this case. For, if Congress specifically legislated in Section 115 (h) that a distribution of stock or securities was not a distribution of earnings, then under ordinary canons of statutory interpretation a distribution of money and property other than stocks and securities would be a distribution of earnings and profits provided it was out of earned surplus.

(c) The Commissioner has attempted to supply the vital defects of the first two steps of his argument by pointing to the Amendment to Section 115 (h) in the Revenue Act of 1938 to include "money or property" within the *Sansome* rule. The Revenue Act of 1938 was enacted two years after the distribution in liquidation herein questioned. And we do not understand that the Commissioner contends that Congress was making the amendment retroactive. As the Commissioner points out in his brief, Section 115 (h) as amended is applicable retroactively to affect 1938 taxes, but this of course does not mean that the amendment affects taxes due under or imposed by the Revenue Act of 1936.[13]

The Commissioner attempts to use the Senate Committee Report accompanying the 1938 Act to prove the rule was the same in 1936 as it would be under the amendment in 1938. It is clear from a reading of the quoted portion of the Committee Report (Commissioner's brief, p. 24)[14] that the Committee had reference to

[13] When Section 115 (h) in the 1938 Act includes distribution before January 1938, it of course means only that for purposes of 1938 distributions, the earlier distributions shall not be considered distributions of earnings or profits.

[14] S. Rept. 1567, 75th Cong., 3rd Sess., pp. 18-19; *Seidman, Legislative History of Federal Income Tax Laws*, p. 64.

tax consequences of a distribution to its stockholders of the property received by the distributee or the tax consequences of *subsequent* distributions by the distributee or the distributor, and nothing more. We repeat that the Second Circuit did not overrule its earlier decision in the *Sansome* case when it said that the *Sansome* principle was not applicable to this case, nor did the Senate Committee, in the portion of its Report quoted by the Commissioner, give any indication that it thought that the *Sansome* rule would be applicable to Section 27 (f) of the Revenue Act of 1936.[15]

2. Section 27 (h) has no bearing here. Section 27 (f) provides that the distribution in this case "shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid". The Commissioner, however, argues (Commissioner's brief, pp. 31-34) that the quoted portion of Section 27 (f) is not applicable in this case because of Section 27 (h), which provides:

> "*Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

[15] If the liquidation and distribution in the instant case had occurred in 1938, we would be faced with the question whether Section 27 (g) of the 1938 Act (which is the same as Section 27 (f) of the 1936 Act) should be controlled and narrowed by the provisions of Section 115 (h) of the 1938 Act. If Section 115 (h) of the 1938 Act would control in such a case, it would not be because of the *Sansome* doctrine but because the statute covered more than the *Sansome* distributee situation. We do not see the relevance of discussing that question in this case. (Compare Commissioner's brief, p. 22; fn. 9.) As the court below pointed out:

> "Whether the same result would be reached under Section 115 (h) of the Act of 1938, which adds tax-free distributions of 'property or money' to the category of transactions not to be considered as distributions of earnings or profits, we have no occasion now to consider." (122 F. (2d), at 365)

As we have shown,[16] and as both the court below and the Second Circuit in the *Kay* case held, Congress did not take away in Section 27 (h) what it allowed in Section 27 (f). If meaning is to be given to the words used by Congress, then 27 (f) requires that this certain type of liquidation distribution shall be treated, for purposes of computing the dividends paid credit, as if it were a taxable dividend. The Commissioner concedes that 27 (f) requires that the distribution be treated as if it were a dividend, but his whole argument is based upon the deletion of the word "taxable" from the statute. The argument is faulty because it presupposes that Congress was unable to write one section without including contradictory subsections. If Section 27 (f) does not require a distribution in liquidation to be treated as "taxable" within the meaning of Section 27 (h), how can it be said that it requires it to be treated as a "dividend" within the meaning of that same Section 27 (h). As the Board put it, "the same phrase which provides treatment of the distribution as a dividend requires treatment as taxable dividend."[17] The result would be that no kind of a liquidation, whether or not under Section 112 (b) (6), would result in a dividends paid credit, and Section 27 (f) would be deprived of meaning. For, as we have shown, if a distribution in liquidation is not taxable, within the meaning of (f), on the same premises it is not *a* dividend, and since it is not a dividend it can never be a taxable dividend within the meaning of (h).

If there were any inconsistency between Section 27 (f) and (h), then (f), specifically dealing with distributions in liquidation, would control the more general (h), which includes all kinds of distribution not in liqui-

[16] *Supra*, pp. 9-10.

[17] 42 B. T. A., at 1025.

dation.[18] Section 27 (h) applies to any distribution which is not in the nature of a liquidating dividend of the kind specified in (f). As is specifically stated, Section 27 (h) applies to stock dividends covered by Section 27 (e) which might not be held to be income to the distributee within the meaning of the Sixteenth Amendment.[19] It applies to distributions contemplated by Section 115 (d) of the Act, which are not in partial or complete liquidation. It applies to distributions out of earnings and profits accumulated prior to 1913. It applies to dividends paid by corporations in one year and not taxable to the recipient until the succeeding year.[20]

To summarize our position, in the words of the Second Circuit in the *Kay* case (122 F. (2d) 443, 445):

> "Having made this specific provision in favor of the liquidating corporation it would be strange indeed if Congress intended to withdraw by paragraph (h) the benefit just granted by paragraph (f). As already shown, a distribution in liquidation of accumulated earnings is never 'a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title'; hence to read those words in paragraph (h) as modifying the language of paragraph (f) would deprive the latter of all utility. In our opinion the Board and the Fourth Circuit rightly refused to do so in the Credit Alliance case."

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[18] *United States* v. *Chase*, 135 U. S. 255, 260. See, in accord, the recent decision by Judge Schwellenbach in *Bracks, et al., Trustees* v. *Hendricksen*, —— F. Supp —— (U. S. D. C., W. D. Wash., Feb. 14, 1942, C. C. H. Fed. Tax Service, par. 9322).

[19] The fact that Section 27 (h) specifically includes the kind of distribution provided for in Section 27 (e) but does not specifically refer to liquidating distributions provided for in Section 27 (f) confirms our position.

[20] *Avery* v. *Commissioner*, 292 U. S. 210; *Commissioner* v. *Adams*, 54 F. (2d) 228 (C. C. A. 1).

B. Article 27 (f)-1 of the Regulations is an unreasonable and unauthorized attempt to amend Section 27 (f)

1. The Regulation ignores the plain meaning of Section 27 (f). The Commissioner places particular stress upon Article 27 (f)-1 of the Regulations, which states that the dividends paid credit provided for in Section 27 (f) will not be allowed in the case of a tax-free distribution within the meaning of Section 112 (b)(6). Up to this point in the brief, we have not made particular reference to the Regulations because we have been engaged in showing that Section 27 (f) stands on its own feet and is not affected by other sections or subsections of the Revenue Act of 1936. It requires in plain and unmistakable language that a distribution in liquidation which in fact represents earnings rather than capital shall be treated as if an ordinary dividend, taxable upon receipt by shareholders, had been paid.

If, as we contend, Section 27 (f) was intended to mean and did mean something which is plain and intelligible, then there is no room for a regulation which is based upon the theory that Section 27 (f) is a confused and equivocal statutory provision. There is no principle of law which authorizes an amendment to the meaning of a statute by Treasury Regulations. This Court has held many times that where "the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland* v. *Helvering,* 298 U. S. 441, 447; *Neuberger* v. *Commissioner of Internal Revenue,* 311 U. S. 83; see also *M. E. Blatt Co.* v. *United States,* 305 U. S. 267, 279; *Manhattan General Equipment Co.* v. *Commissioner,* 297 U. S. 129, 134.

The Commissioner argues that the Regulations received Congressional approval in the Revenue Act of 1938. Evidence of that approval is stated to be the amendment of Section 115 (h) in the 1938 Act to include distributions of money and property where before it had covered only distributions of stock or securities. This is the reverse of Congressional approval. If Congress had thought that the Regulations correctly interpreted its meaning expressed in the 1936 Act, there of course would have been no necessity for an amendment in the 1938 Act.[21] The fact that "property or money" was included in Section 115 (h) of the 1938 Act, which might or might not[22] be relevant in the case of a 1938 liquidation, is the best kind of evidence that Section 115 (h) of the 1936 Act did not apply to distributions of property or money in liquidation. Since it did not apply to such a distribution, there is no room for change by the Regulations.

> "In so far as Article 27 (f) of Treasury Regulations 94 purports to establish a rule contrary to the construction of the section we have approved, we

[21] The cases cited by the Commissioner in his brief, at p. 26, in support of his contention that there was Congressional ratification are all wide the mark. A good example is *White* v. *Winchester Country Club*, No. 63 this Term, decided January 12, 1942. In that case, Congress had used in a statute the equivocal words "dues or membership fees". The Commissioner, by administrative ruling, held that the payment for certain club privileges came within this statutory classification. In a later Act, Congress made the terms more definitive and this Court thereafter held that as a matter of initial statutory construction the Commissioner was correct, and that the amplification (as distinguished from change) by Congress in the later Act could be viewed as an approval of the Commissioner's ruling. That seems to us to be the reverse of the situation we have in the instant case. The Commissioner has not been defining the meaning of the word "taxable" in 27.(f). Instead, he has attempted to strike it right out of the statute. None of the cases he cites warrants this kind of administrative repeal.

[22] See p. 24, fn. 15, *supra*.

agree with the Fourth Circuit that it is unauthorized."[23]

Quite apart from this, as we have pointed out, (see fn. 2, p. 5, *supra*) the undistributed profits surtax was completely abandoned in 1938.

2. The Regulation is contrary to the purpose of Section 27 (f). The gist of the Commissioner's contention that the Regulations should control seems to be that if the credit is allowed in this case, the purpose of the undistributed profits tax will have been circumvented. That was a question for the judgment of Congress and not the Commissioner. But it is well to point out that Section 27 (f) fulfills the intention of Congress to encourage the simplification of corporate structures and is not contrary to the theory of the undistributed profits tax.

President Roosevelt, in a message to Congress in 1935, urged that the simplification of complicated corporate structures should be encouraged by revisions of the tax laws.[24] Accordingly, Congress in 1935 enacted two statutes encouraging simplification of corporate structures. On the positive side, Section 110 (a) of the Revenue Act of 1935 granted a tax benefit to those who would liquidate unnecessary subsidiaries by permitting them for the first time to do so without recognition of gain or loss. (Appendix A, p. 38, *infra*.) On the negative side, Section 102 (h) of the Revenue Act of 1935 placed a tax burden upon unnecessary corporate chains by imposing for the first time an inter-corporate dividend tax.

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[23] *Commissioner of Internal Revenue* v. *Kay Mfg. Co.*; 122 F. (2d) 443, at 445.

[24] "We should seek through taxation the simplification of our corporate structures through the elimination of unnecessary holding companies in all lines of business." (Message of the President, June 19, 1935, H. R. Rept. No. 1681, 74th Cong., 1st Sess., p. 4.)

When the Revenue Act of 1936 was enacted, both of these features of the 1935 Act were retained and other inducements to simplification were added. Section 110 (a) of the Revenue Act of 1935 was revised, broadened and re-enacted as Section 112 (b) (6) of the 1936 Act. Senator George, for the Senate Finance Committee, stated on the Floor of the Senate (80 Cong. Rec. 8799):

> "Section 112 (b) (6) of the present law was adopted last year by the Senate, as an amendment to the revenue bill of 1935. It was intended to permit the simplification of our corporate structures and the liquidation of subsidiaries."

Similarly, in the House, Representative Doughton, speaking for the Ways and Means Committee, explained (80 Cong. Rec. 10270):

> "Certain changes have been made in respect to the provision governing the liquidation of corporations which should facilitate the simplification of corporate structures."

There can be no question but that Section 112 (b) (6) was intended to encourage corporate simplification by removing the only deterrent then existing to liquidation of unnecessary subsidiaries—the recognition of gain to the *distributee* corporation.

At the same session at which liquidation was thus further encouraged, however, Congress was considering a new potential deterrent to liquidations—an undistributed profits tax upon the *distributor* corporation. Congress was determined that the potential threat should not be realized, and so Section 27 (f) was placed in the undistributed profits tax Act. The section covers the liquidation of unnecessary subsidiaries and any other kind of a liquidation, granting in each case a "taxable dividend paid" credit. In this respect, therefore, Sec-

tion 112 (b) (6) and Section 27 (f) are mutually complementary; both were deemed necessary by Congress to the fulfillment of its announced plan for the simplification of corporate structures through liquidation.

The Board of Tax Appeals in the instant case recognized the foregoing underlying purpose of Section 27 (f) when it said:

> "We think it obvious that Congress had in mind both the idea of forcing the payment of tax upon corporate earnings *and of encouraging liquidations of corporations forming parts of corporate chains.*"[25] (Italics supplied.)

The Circuit Court of Appeals likewise pointed out that the decision in respondent's favor

> "gives effect to the *coordinate purpose* of the Act manifested in this section and also in Section 112 (b) (6) to encourage the simplification of corporate structures by liquidation."[26] (Italics supplied.)

Finally, the Second Circuit in the *Kay* case said:

> "It should not be overlooked that the Revenue Act of 1936 was intended not only to raise revenue *but also to encourage the simplification of corporate structures.*"[27] (Italics supplied.)

This does not mean that Section 27 (f) grants any exemption to a liquidating corporation which it would not enjoy if it did not liquidate. The purpose is rather to avoid penalizing a corporation that is liquidating. It is clear that under 27 (a) a going concern is entitled to a dividends paid credit for a distribution to its par-

[25] 42 B. T. A. 1020, 1022.
[26] 122 F. (2d) 361, 365.
[27] 122 F. (2d) 443, 445.

ent. There is a like distribution in the case of a liquidation and accordingly there is no reason why a dividends paid credit should be denied in the latter case. The Commissioner objects because the *distributee* does not pay an undistributed profits tax on the sum received. Section 27 (f) has nothing to do with that for it is the mandate of Section 112 (b)(6) which controls. The Congressional history is clear that Congress did not intend to restrict the application of Section 112 (b)(6) and the Regulations are totally unauthorized in attempting to place such a restriction under the guise of an amendment to the plain meaning of Section 27 (f).

It is important to note that the clear Congressional purpose was adequately safeguarded from circumvention. Section 102 of the Act imposes a surtax upon corporations improperly accumulating surplus through the medium of permitting earnings or profits to accumulate instead of being divided or distributed. This means that if the distributee in later years makes profits which it does not need, because of the assets it already has (which include the sums received from respondent), it must distribute that portion of its later earnings that it does not need or pay a heavy penalty tax under Section 102. Furthermore, Section 27 (f) is applicable only to a *bona fide* liquidation, as the liquidation of Credit Alliance admittedly was. Any attempt to create a subsidiary for the purpose of avoiding the undistributed profits tax through the guise of a liquidation can and should be met with the argument provided by *Gregory* v. *Helvering*, 293 U. S. 465, and related cases, and not by distorting the plain words of the statute and penalizing *bona fide* liquidations.

It should suffice for purposes of this case to show that the Commissioner really is attacking Section 112 (b)(6) by an attempt to amend Section 27 (f), but the effect of the Regulations would be to place such a penalty upon *bona fide* liquidations that it is impossible to think that the Commissioner interprets the Congressional purpose. In this particular case, for example, Credit Alliance could not have liquidated at all without paying almost twice the taxes that would have been imposed had it not liquidated and had declared dividends out of these earnings.

Credit Alliance would have received a dividends paid credit if it had not liquidated but had distributed its earnings by way of an ordinary dividend. Had it done so, it clearly would have paid no undistributed profits tax. The parent distributee would have paid an undistributed profits tax, assuming, as was the case here, that the parent did not distribute any of the money and property received, of $62,521.24 and an increase in normal income tax of $13,424.10. The computations by which these amounts are determined from the record are set out in Appendix B to this brief, p. 53, *infra*. Credit Alliance did not make distribution by way of an ordinary dividend; but instead, to simplify the corporate structure, the parent liquidated Credit Alliance pursuant to Section 112 (b)(6).[28] Because this was done, even though the Commissioner must concede that Congress wanted this kind of thing done, the Commissioner now claims that an undistributed profits tax of $121,814.49 is owing.

We are not complaining because the Commissioner is attempting to assess a higher tax than we would have

[28] Since it owned over 80% of all the stock of Credit Alliance, it would have been difficult for the parent to take the liquidation without the scope of Section 112 (b) (6).

been required to pay if we had liquidated in some other way. We complain because the Commissioner is asserting an unauthorized penalty against liquidations. It is, therefore, no answer to say (see Commissioner's brief, pp. 29-30) that we could have avoided the tax by refusing to liquidate, or that the parent company could have refused to distribute its own earnings (see Commissioner's brief, p. 29, fn. 16) which would of course be contrary to the obvious purpose of the Act.

Nor is it any answer to say that Credit Alliance could have distributed these earnings as a dividend and could thereafter have liquidated because the Commissioner takes the position that the dividend is part and parcel of the liquidation, and the Board of Tax Appeals has so held.[29] On the theory that the Commissioner advances in this case, a corporation which ought to be liquidated is in a dilemma. It is subject to the heavy liquidating tax whether it distributes earnings in liquidation or distributes earnings and then liquidates. Congress imposed no such dilemma, for it specifically refused in Section 27 (f) to assess a penalizing tax upon a joinder of the acts of distribution and liquidation. On this point, the legislative history is conclusive.[30]

The only answer that the Commissioner makes to this extraordinary disregard of the Congressional purpose is to say that Article 27 (f)-1 (c) of the Regulations creates a method by which the transferee corporation

[29] Cf. *The Biltmore Co.*, B. T. A. Memo. decision (Docket No. 100709, C. C. H. Dec. 11, 361-G.); *Holmby Corp.* v. *Commissioner*, 83 F. (2d) 548 (C. C. A. 9); *Canal-Commercial Trust & Savings Bank* v. *Commissioner*, 63 F. (2d) 619 (C. C. A. 5); *Gossett* v. *Commissioner*, 59 F. (2d) 365 (C. C. A. 4).

[30] Senator La Follette, in discussing the Conference Report on the Floor of the Senate, pointed out to the Senate that the liquidation provisions were placed in the Revenue Act of 1936 "to enable corporations with complicated corporate structures to liquidate and not to pay excessive penalties in the process". (80 Cong. Rec. 10469)

may, subject to approval by the Commissioner, apportion and allocate to the transferor corporation any dividends paid credit allowed the transferee corporation for dividends paid to its shareholders during the portion of the taxable year subsequent to its receipt of the distribution from the distributor. In other words, says the Commissioner, if the parent corporation had declared a dividend to its shareholders immediately after receipt of the distribution from Credit Alliance on December 10, 1936, it might have, if the Commissioner had permitted it, donated so much of the resulting dividends paid credit as it wished to Credit Alliance, keeping the rest for itself.

We think argument is unnecessary to show that nowhere in the Revenue Act of 1936 or in its Congressional history is there any authorization for the Commissioner to embark on this complex scheme. Indeed, the Commissioner has argued before the Board in this case that the validity of this portion of the Regulations was not involved and the Board so held.[31] Even now, the Commissioner says that Credit Alliance cannot object to the extraordinary scheme because it is intended to aid Credit Alliance. But if the Commissioner wants to rely on this portion of the Regulations to justify his attempt to amend Section 27 (f), the validity and authorization of Article 27 (f)-1 (c) is certainly subject to question. If, as we think is plain, Article 27 (f)-1 (c) is invalid, then the rest of the Commissioner's interpretation of 27 (f) falls with it. As the court below said:

> "The government also refers, without avail to Article 27 (f) of Treasury Regulations 94, which, without legislative sanction, authorizes a distributee in liquidation to allocate or transfer a dividends paid credit earned by it under the Act to its dis-

[31] 42 B. T. A., at 1029.

tributor. Indeed this regulation serves to indicate that the Treasury's interpretation of Section 27 (f) imposes so unreasonable a burden on the distributor in liquidation that some affirmative action to alleviate the consequences, at least in part, was required."[32]

Finally, the Commissioner says that 27 (f) allows an "exemption from tax" and that the principle announced by this Court in *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, is applicable (Commissioner's brief, pp. 35-36). This is not an exemption as that term is used by this Court. In the *Northwest Steel Mills* case, the corporation attempted to obtain credit under Section 26 (c) of the Act, although it did not distribute or transfer anything. This Court, of course, said that Section 26 (c), which in certain cases gives a special credit even though there has been no transfer of any monies at all, should be strictly construed. Admittedly, respondent in this case distributed everything it had and Section 27 (f) grants no exemption of any kind but merely directs that the distribution constitutes a dividends paid credit. Indeed, the whole purpose of Section 27 is to deduct the income that is distributed in order to determine the undistributed remainder of income upon which the tax is imposed.

CONCLUSION

The Commissioner would have us think that the Revenue Act of 1936 was so confused that it was necessary for a Regulation to legislate "novel provisions to be woven into interrelated sections of unusual complexity so as to achieve harmonious administration".[33]

There is nothing complex or involved in our position, which is that Congress used simple and intelligible lan-

[32] 122 F. (2d), at 366.

[33] Commissioner's brief, pp. 12-13.

guage in Section 27 (f) of the 1936 Act. Because its meaning and purpose is plain, no weight should be given to the Regulations which attempt to amend Section 27 (f) out of existence.[34] We rely upon a strict construction of the statute, for we have in mind the teaching of this Court that:

> "* * * the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." (*Lynch v. Alworth-Stephens Co.*, 267 U. S., at 370.)

The decision of the Circuit Court of Appeals was correct and should be affirmed.

Respectfully submitted,

NEWELL W. ELLISON,
MARION P. WORMHOUDT,
CHRISTOPHER S. SARGENT,
701 Union Trust Building,
Washington, D. C.

DUANE R. DILLS,
JACK J. LEVINSON,
100 East 42nd Street,
New York City,
Attorneys for Respondent.

March 30, 1942.

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[34] "Under different circumstances great weight has been attached to administrative practice and Treasury rulings, but beyond question they cannot narrow the scope of a statute when Congress plainly has intended otherwise." (*Neuberger v. Commissioner of Internal Revenue*, 311 U. S. 83 (1940)).

APPENDIX A

Pertinent Provisions of Statutes and Regulations

1. *REVENUE ACT OF 1935*

Sec. 102. Income Taxes on Corporations.

* * * * *

(h) Section 23(p) of the Revenue Act of 1934 (relating to the deduction of dividends received by corporations) is amended by striking out the words "the amount" and inserting in lieu thereof the following: "90 per centum of the amount."

Sec. 110. Corporate Liquidations.

(a) Section 112(b) of the Revenue Act of 1934 is amended by adding after paragraph (5) a new paragraph reading as follows:

"(6) *Exchange in Liquidation.*—No gain or loss shall be recognized upon the receipt by a corporation of property (other than money) distributed in complete liquidation of another corporation, if the corporation receiving such property on such exchange was on the date of the enactment of the Revenue Act of 1935 and has continued to be at all times until the exchange, in control of such other corporation. As used in this paragraph 'complete liquidation' includes any one of a series of distributions by a corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding five years from the close of the taxable year during which is made the first of the series of distributions under the plan. If such transfer of property is not completed within the taxable year the Commissioner may require of the taxpayer, as a condition to the non-recognition of gain under this paragraph, such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure the assessment and collection of the tax if the transfer of the property is not completed in accordance with the plan. This paragraph shall not apply to any liquidation if any distribution in pursuance thereof has been made before the date of the enactment of the Revenue Act of 1935."

2. REVENUE ACT OF 1936

Sec. 13. Normal Tax on Corporations.

* * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation, a normal tax as follows:

Upon normal-tax net incomes not in excess of $2,000, 8 per centum.

$160 upon normal-tax net incomes of $2,000; and upon normal-tax net incomes in excess of $2,000 and not in excess of $15,000, 11 per centum in addition of such excess.

$1,590 upon normal-tax net incomes of $15,000; and upon normal-tax net incomes in excess of $15,000 and not in excess of $40,000, 13 per centum in addition of such excess.

$4,840 upon normal-tax net incomes of $40,000; and upon normal-tax net incomes in excess of $40,000, 15 per centum in addition of such excess.

(c) *Exempt Corporations.*—For corporations exempt from taxation under this title, see section 101.

(d) *Banks and Trust Companies.*—For rate of tax on certain banks and trust companies, see section 104.

Sec. 14. Surtax on Undistributed Profits.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate (as defined in section 2 of the Banking Act of 1933), the amount allowed as a credit under section 26(d).

(D) In the case of a national mortgage association created under Title III of the National Housing Act, the amount allowed as a credit under section 26(e).

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends

paid credit provided in section 27 and the credit provided in section 26(c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

Sec. 26. Credits of Corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax:

* * * *

(b) *Dividends Received.*—85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this title. The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

Sec. 27. Corporation Credit for Dividends Paid.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

(b) *Dividend Carry-Over.*—In computing the dividends paid credit for any taxable year, if the dividends paid during the taxable year are less than the adjusted net income, there shall be allowed as part of the dividends paid credit, and in the following order:

(1) Dividends paid during the second preceding taxable year in excess of the adjusted net income for such year, to the extent not needed as a dividends paid credit for the taxable year preceding the taxable year the tax for which is being computed; and

(2) Dividends paid during the first preceding taxable year in excess of the adjusted net income for such year.

No credit shall be allowed for dividends paid by a corporation prior to its first taxable year under this title.

(c) *Dividends in Kind.*—If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the dividends paid credit with respect thereto shall be the adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.

(d) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value is lower than the face value, then when the obligation is redeemed by the corporation, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

(e) *Taxable Stock Dividends.*—In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115(f), the dividends paid

credit with respect thereto shall be the fair market value of the stock or the stock right at the time of the payment.

(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

(g) *Preferential Dividends.*—No dividends paid credit shall be allowed with respect to any distribution unless the distribution is pro rata, equal in amount, and with no preference to any share of stock as compared with other shares of the same class.

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

Sec. 112. Recognition of Gain or Loss.

* * * *

(b) *Exchanges Solely in Kind.*—

(6) Property Received by Corporation on Complete Liquidation of Another.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except non-voting stock which is limited and preferred as to

dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the stockholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not com-

pleted within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

Sec. 115. Distributions by Corporations.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have

been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117(a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

(d) *Other Distributions from Capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(e) *Distributions by Personal Service Corporations.*—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions

of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(f) *Stock Dividends.*—

(1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) Election of shareholders as to medium of payment.—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means as distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

3. REVENUE ACT OF 1938

Sec. 115. Distributions by Corporations.

* * * *

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or be-

because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

4. REGULATIONS 94

Art. 27(f)-1. Dividends paid credit for distributions in liquidation.

(a) *Distributions which diminish earnings or profits.*— To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27(f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Act as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if—

(1) Under the provisions of section 115(c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, a dividends paid credit is allowable for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from

its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.*— In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913. The application of this paragraph may be illustrated by the following example:

Example: The Y Corporation was organized on January 1, 1910, with an authorized and outstanding capital stock of 2,000 shares of common stock of a par value of $100 each and 1,000 shares of participating preferred stock of a par value of $100 each. The preferred stock was to receive annual dividends of $7 per share and $100 per share on complete liquidation of the corporation in priority to any payments on common stock, and was to participate equally with the common stock in either instance after the common stock had received a similar amount. However, the preferred stock was redeemable in whole or in part at the option of the board of directors at any time at $106 per share plus its proportion of the earnings of the company at the time of such redemption. In 1910 the preferred stock was issued at $106 per share, for a total of $106,000, and the common stock was issued, at $100 per share, for a total of $200,000. On July 15, 1936, the company had a paid-in

surplus of $6,000, consisting of the premium received on the preferred stock, earnings or profits of $30,000 accumulated prior to March 1, 1913, and earnings or profits accumulated since February 28, 1913, of $75,000. On July 15, 1936, the option with respect to the preferred stock was exercised and the entire amount of such stock was redeemed at $141 per share or a total of $141,000 in a transaction upon which gain or loss to the distributees resulting from the exchange was determined and recognized under the Act, such transaction being only a partial liquidation under section 115(c). The amount of the distribution allocable to capital account was $116,000 ($100,000 attributable to par value, $6,000 attributable to paid-in surplus, and $10,000 attributable to earnings or profits accumulated prior to March 1, 1913). The remainder, $25,000 ($141,000, the amount of the distribution, less $116,000, the amount allocable to capital account) is properly chargeable to the earnings or profits accumulated since February 28, 1913, and is allowable as a dividends paid credit.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.*—If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of the transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the purposes of the dividends paid credit, any such distribution so allocated shall be treated as a dividend paid only in the computation of the credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as a part of its return for the taxable year involved, (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both

corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No dividends paid credit based upon such apportionment and allocation will be allowed unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph. The provisions of this paragraph may be illustrated by the following example:

Example: The P Corporation, which keeps its books and makes its income tax returns on the basis of a fiscal year ending March 31, owned all of the capital stock of the S Corporation. The S Corporation, which keeps its books and makes its returns on the calendar year basis, was completely liquidated on December 1, 1936. At that time, the S Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $50,000, in addition to earnings or profits for 1936 of $20,000, and an adjusted net income of $45,000. It had paid no dividends prior to its liquidation. The P Corporation had earnings or profits accumulated subsequent to February 28, 1913, in the amount of $60,000 in addition to earnings or profits of the taxable year computed as of the end of the year in the amount of $80,000, and an adjusted net income in the amount of $60,000. The P Corporation pays dividends as follows: June 15, 1936, $25,000; September 15, 1936, $25,000; December 15, 1936, $25,000; and March 15, 1937, $25,000. No portion of the dividends paid on June 15 and September 15 prior to the liquidation and no portion of the dividend paid on March 15, 1937, after the close of the taxable year of the S Corporation may be allocated to the S Corporation. The dividend paid on December 15 may, by appropriate corporate action, be made as one effecting a distribution out of the current earnings or profits of the S Corporation to the extent of $20,000. No part of that distribution may be allocated to the S Corporation's accumulated earnings or profits since, under section 115 (b), the earnings or profits of the P Corporation and the S Corporation for the taxable year ($100,000) are sufficient in amount to cover all the distributions made during that year ($100,000).

Art. 27(h)-1. Nontaxable distributions.—No dividends paid credit shall be allowed with respect to any part of the distribution by a corporation to its shareholders which is—

(a) not out of earnings or profits of the taxable year or out of earnings or profits of the corporation accumulated subsequent to February 28, 1913 (see section 115), or, in the case of distributions in liquidation, not properly chargeable to earnings or profits of the corporation accumulated after February 28, 1913, under article 27(f)-1;

(b) in the case of a corporation which was classified as a personal service corporation under the Revenue Act of 1918 or the Revenue Act of 1921, out of earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921 (see section 115(e)); or

(c) a distribution in stock of the corporation or rights to acquire its stock which does not constitute income to its shareholders within the meaning of the sixteenth amendment to the Constitution (see section 115(f) and articles 115-3 and 115-4).

The effect of subsections (g) and (h) of section 27 is that no dividends paid credit is allowed with respect to any distribution unless each of the shareholders of that class, who are subject to taxation under Title I for the period in which the distribution is made, receives a taxable dividend as a result of the distribution.

The application of section 27(h) may be illustrated by the following examples:

Example (1): A, B, C, and D are the shareholders of the Y Corporation, which makes its returns on the calendar year basis, D being an educational corporation exempt from income tax under section 101. On July 15, 1936, the Y Corporation paid a dividend (within the meaning of section 115) in cash of $1,000. A and B make their returns on the calendar year basis, but C makes his return on the basis of the fiscal year ending July 31. The Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

Example (2): If the facts in the preceding example are the same, except that A and B make their returns on the basis of the fiscal year ending July 31, the Y Corporation is entitled to a dividends paid credit in the amount of $1,000 with respect to the dividends paid on July 15.

APPENDIX B

COMPUTATION OF UNDISTRIBUTED PROFITS TAX IF ALL OF ADJUSTED NET INCOME OF CREDIT ALLIANCE CORPORATION HAD BEEN DISTRIBUTED IN 1936 AS AN ORDINARY DIVIDEND

I. CREDIT ALLIANCE CORPORATION

If all of the adjusted net income had been distributed as a dividend there would obviously have been no undistributed profits tax due from the Credit Alliance Corporation.

(1) Net income (per 90-day letter, R. 7)	$	703,147.25
(2) Normal tax (per 90-day letter, R. 7)		104,312.09
(3) Adjusted net income (per 90-day letter, item (1) less item (2), *supra*)	$	598,835.16
(4) Amount which would have been distributed to all shareholders as ordinary dividend		598,835.16
(5) Undistributed net income (item (3) less item (4), *supra*)	$	0.00
(6) Undistributed profits tax	$	0.00

II. COMMERCIAL CREDIT COMPANY

If all of the adjusted net income of Credit Alliance Corporation had been distributed as a dividend, Commercial Credit Company as the owner of 526,238 out of 528,186 shares would have received $596,626.54, upon which it would have paid an additional undistributed profits tax of $62,521.24.

(7) Net income (per return, R. 40)	$11,812,303.10
(8) Additional income which would have been received as ordinary dividend from Credit Alliance Company $\left\{\frac{526,238}{528,186}\right.$ of item (4), *supra*)	596,626.54
(9) Total net income (item (7) plus item (8), *supra*)	$12,408,929.64
(10) Normal tax paid (per return, R. 40)	$ 1,019,748.48
(11) Intercorporate dividend tax (15% of 15% of item (8), *supra*)	13,424.10
(12) Total normal tax (item (10) plus item (11))	$ 1,033,170.58
(13) Adjusted net income (item (9) less item (12), *supra*)	$11,375,759.06
(14) Dividends paid (per return, R. 40)	9,804,241.77
(15) Undistributed net income (item (13) less item (14))	$ 1,571,517.29

Computation of undistributed profits surtax (sec. 14 (b)):

(16) 10% of adjusted net income (10% of item (13))	$ 1,137,575.91
(17) Balance of undistributed net income (item (15) less item (16))	433,941.38
(18) Surtax of 7% on item (16)	79,630.31
(19) Surtax of 12% on item (17)	52,072.97
(20) Total undistributed profits surtax (item (18) plus item (19))	$ 131,703.28
(21) Undistributed profits surtax paid (per return)	69,182.04
(22) Additional undistributed profits surtax (item (20) less item (21))	$ 62,521.24

SUPREME COURT OF THE UNITED STATES.

No. 708.—October Term, 1941.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Credit Alliance Corporation.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[April 27, 1942.]

Mr. Justice Roberts delivered the opinion of the Court.

The Commercial Credit Company, a Delaware corporation, acquired and owned over 99% of the capital stock of the respondent, a New York corporation actively engaged in business. In 1936 the respondent's stockholders and directors resolved to liquidate the corporation and to make distribution to its stockholders in liquidation. Part of the distribution so made in 1936 was of cash and property constituting surplus earned after February 28, 1913, of the value of $950,734. Of this Commercial Credit Company's share was $947,228. Further distributions were made in 1937 and final distribution in 1938, and the corporation was legally dissolved. The liquidation complied with the provisions of §112(b)(6) of the Revenue Act of 1936,[1] under which no gain or loss for tax purposes was attributable to Commercial Credit Company as a result of the distribution. That corporation did not, in 1936, distribute to its stockholders any of the distribution received by it from the respondent and did not apportion or allocate any part thereof to the respondent.

The question is, to what dividends paid credit is the respondent entitled under the applicable sections of the Revenue Act of 1936.[2]

By § 14 there was imposed for the first time a tax upon "undistributed net income". In order to compute the base for this levy the dividends paid credit is to be deducted from adjusted net income.

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[1] 49 Stat. 1648, 1679.

[2] §§ 14, 27, and 112. 49 Stat. 1648, 1655, 1665, 1678.

Section 27 deals with the credit for dividends paid. Subsection (a) provides that, for the purposes of Title I of the Act, the dividends paid credit shall be the amount of dividends paid during the taxable year. Each of the additional subsections deals with a separate topic relating to the computation and allowance of the credit. The only ones here of importance are (f) and (h):

"(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

"(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

The taxpayer insists that the distribution in question is governed by the provisions of (f). The Government asserts that it is not, for these reasons: that the phrase "which is properly chargeable to the earnings or profits accumulated after February 28, 1913" takes the distribution out of the purview of the section; that (h) denies the benefit of (f) to the taxpayer if the money or property transferred is not taxable to the distributee; that the policy of the Act, and the purpose underlying provisions other than § 27, require that (f) be not construed as permitting the credit where the distribution gives rise to no tax upon the distributee, and that an applicable regulation precludes the credit.

The Government's second contention has been sustained by the Circuit Court of Appeals for the Fifth Circuit,[3] but both the first and the second have been overruled by the Circuit Court of Appeals for the Second Circuit,[4] and by the Board of Tax Appeals and the court below in the instant case.[5] In view of the conflict we granted certiorari.

1. Although a distribution in liquidation of earnings which accrued subsequently to February 28, 1913, does not constitute a

[3] Centennial Oil Co. *v.* Thomas, 109 F. 2d 359; Hutcheson, J., dissenting.
[4] Commissioner *v.* Kay Mfg. Corp., 122 F. 2d 443.
[5] 42 B. T. A. 1020; 122 F. 2d 361.

dividend in the proper sense of the term,[6] subsection (f) categorically declares that a liquidating distribution, to the extent it is composed of such earnings, shall, for the purposes of computing the dividends paid credit "*be treated as a taxable dividend paid.*" Plainly the section intends that a distribution of such earnings shall be considered a dividend. Further it provides that the distributing corporation may use the amount in computing its credit for dividends paid. And, to put the matter beyond cavil, the section also says that the distribution shall be treated as the payment to the distributee of a *taxable* dividend.

The Government, however, contends that the clause "properly chargeable to the earnings or profits accumulated after February 28, 1913," means properly chargeable to the distributee as such earnings or profits. The argument has, we think, rightly been rejected by all the courts which have considered it. The line drawn in all of the revenue acts between profits accumulated before the enactment of the first income tax act and after that date for distinguishing capital and income furnishes the reason for the insertion of the clause in subsection (f). Section 27 deals with a credit to the distributing corporation and the phrase finds its proper office in limiting the amount of the distribution in liquidation which may be considered a dividend from earnings or profits as distinguished from one composed of capital. We, therefore, conclude that (f), standing alone, justifies the deduction claimed by the respondent.

2. It is urged that the sweeping provision of (h) precludes the application of (f) in the circumstances disclosed, because (h) denies the credit unless the amount distributed is taxable to the distributee. By concession the distribution here does not result in gain or loss to the parent company. The argument is in effect that (h) creates an exception to the rule formulated by (f).

As above said, each of the subsections of § 27 deals with a specific and particular topic. Subsection (f) deals with "distributions in liquidation" while subsection (h) deals with "nontaxable distributions". If (f) applies in this case, (h) is left to cover a substantial field of other sorts of distributions. We should, of course, read the two sections as consistent rather than conflicting, if that be possible. Here it is not only possible but begets no absurd or impractical result. We hold that (h) is not applicable to the facts of this case and that (f) is.

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[6] Hellmich v. Hellmann, 276 U. S. 233.

3. The petitioner points out that the Revenue Act of 1936 introduced a new policy,—to tax undistributed earnings in order to prevent a taxpayer from accumulating untaxed surplus by forcing the payment of dividends which become taxable in the hands of the distributee. This is true, but it is also true that the Act made distributions to parent corporations nontaxable in order to encourage the simplification of corporate structures. It was avowedly for this reason that § 112(b)(6) provided that no gain or loss to the parent company should in such case be recognized, and it may well be that subsection (f) of § 20 was inserted with the same purpose. The Government insists that as § 115(h)[7] provides that a distribution of the taxpayer's stock or securities, or those of another corporation, shall not be considered a distribution of earnings or profits of the taxpayer if no gain to the distributee from the receipt of such stock or securities is recognized by the law, subsection (f) must be read in the light of the policy thus declared by § 115(h). The latter section is irrelevant to this controversy because the distribution here was in property and money and not in stock or securities. Section 115(h) was amended in 1938 subsequent to the consummation of the transaction here in question to include money or property, but we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment.

We shall not burden this opinion by extended reference to the legislative history of the Act of 1936. It is enough to say that it is inconclusive and, to some extent, supports the arguments of both parties. But whatever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of subsection (f).

4. Treasury Regulations 94, Art. 27(f), declare that one making a liquidating distribution of earnings accumulated since February 28, 1913, must be denied the dividends credit in respect of such distribution unless the amount distributed is taxable in the same year to the distributee, but further provides that if the distributee, in that year, makes a distribution which entitles it to a dividends credit it may allocate a proper proportion thereof to the distributor of the liquidating dividend. It is insisted that the situation presented to the Treasury by the various provisions of the Revenue

[7] 49 Stat. 1688.

Act of 1936 was confused and complex and the adoption of the regulation was proper in the circumstances and should control.

In view of what we have said as to the plain meaning of subsection (f), we think that no complexity or confusion is discoverable and that the regulation not only was contradictory of the plain terms of the subsection but attempted to add a supplementary legislative provision, which could only have been enacted by Congress. We hold, therefore, that the court below was right in refusing to give effect to the regulation.

The judgment is affirmed.

The CHIEF JUSTICE took no part in the consideration or decision of this case.

Mr. Justice BLACK, Mr. Justice REED and Mr. Justice DOUGLAS dissent. They are of the opinion that since Art. 27(f) of Treasury Regulations 94 resolves the ambiguities between § 27(f) and § 27(h) of the Revenue Act of 1936 it is a valid interpretative regulation and a proper exercise of the rule-making authority.

A true copy.

Test:

Clerk, Supreme Court, U. S.